2005 Report

The Corporations Committee
of the Business Law Section of
The State Bar of California

Legal Opinions in Business Transactions
(Excluding the Remedies Opinion)

May 2005

The 2005 edition of this report (this "Report")* has been prepared by the Corporations Committee (the "Committee") of the Business Law Section of the State Bar of California (the "Business Law Section") and issued by the Committee with the approval of the Executive Committee of the Business Law Section. The editors and contributors to this Report are the following:

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This Report was drafted, reviewed, and edited by the Committee, commencing in the winter of 2003-2004 and completed in early 2005. The report is the work product of the entire Committee; the composition of the Committee during these two "Committee years" was as follows:

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NOTE REGARDING 2005 EDITION

This Report supersedes the corresponding report issued in 1989 by the Committee (published in 45 *Business Lawyer* 2169 (1990)) (the "1989 Report"). Substantial portions of this Report are based on corresponding portions of the 1989 Report and no claim of authorship is made by the contributors of this Report with respect to corresponding original text upon which it is based.

The portion of the 1989 Report that addressed issues regarding remedies is not included in this Report but instead is covered in a separate report of the Opinions Committee of the Business Law Section as identified in the Introduction to this Report.

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INTRODUCTION

This report ("Report") is a commentary on the use of legal opinions in business transactions, with particular consideration of the impact of California law and practice on such opinions. It has been prepared by the Corporations Committee (the "Committee") of the Business Law Section of the State Bar of California (the "Business Law Section") and issued by the Committee with the approval of the Executive Committee of the Business Law Section. This Report supersedes the opinion report prepared by the Committee in 1989 (the "1989 Report"),[1] which itself updated and restated the opinion report prepared by the Committee in 1982.[2] This Report is not intended to prescribe specific forms of legal opinions expressed in opinion letters or required procedures for rendering them, but rather is intended to reflect current opinion practice in California as understood by the Committee. The views set forth in this Report represent a consensus among the Committee members listed on pages (i) and (ii) of this Report, but do not necessarily reflect the positions of individual members or their respective firms or organizations.

Since the 1989 Report was published, there have been several important contributions to the commentary on legal opinions and their content. In 1991, the Legal Opinions Committee of the American Bar Association (the "ABA Committee") published its Third-Party Legal Opinion Report, including the Legal Opinion Accord (the "Accord").[3] Rather than summarizing opinion practice, the Accord proposed to govern the terms and conditions of opinions that adopted the Accord. An Accord opinion would therefore incorporate all assumptions and conditions set forth as standard terms of the Accord, without having to restate those assumptions or conditions.[4] In 1992, the Business Law Section issued a report designed to provide guidance to members of the State Bar of California who wished to adopt the Accord for opinions.[5] The Accord did not gain widespread acceptance in California but is still used as a resource in preparing opinion letters, much as the 1989 Report was intended to be used.

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1 Comm. on Corps., State Bar of California, *1989 Report of the Committee on Corporations Regarding Legal Opinions in Business Transactions*, 45 BUS. LAW. 2169 (1990) [hereinafter *1989 Report*].

2 Comm. on Corps., State Bar of California, *Report of the Committee on Corporations Regarding Legal Opinions in Business Transactions* (1982), *reprinted in* 14 PAC. L.J. 1001 (1983).

3 Comm. on Legal Opinions, American Bar Association, *Third-Party Legal Opinion Report, including the Legal Opinion Accord, of the Section of Business Law, American Bar Association*, 47 BUS. LAW. 167 (1991) [hereinafter *Accord*]. The 1991 Third-Party Legal Opinion Report includes not only the Accord but also "Certain Guidelines for the Negotiation and Preparation of Third-Party Legal Opinions." These guidelines have been superseded. *See* note 8. Accordingly, references in this Report to the Accord do not include the guidelines published in 1991 with the Accord.

4 The Accord does provide for "private ordering," which allowed for modifications to the Accord's provisions for a specific opinion letter.

5 Business Law Section, State Bar of California, *Business Law Section of the State Bar of California Report on the Third-Party Legal Opinion Report of the ABA Section of Business Law* (1992). The 1992 report also offers a summary of the differences between positions taken in the 1989 Report and the Accord.

In 1998, the TriBar Opinion Committee issued its report on Third-Party Closing Opinions (the "TriBar Report")[6] and the ABA Committee issued its Legal Opinion Principles (the "ABA Principles").[7] In 2002, the ABA Committee published an update to its Guidelines for the Preparation of Closing Opinions (the "ABA Guidelines"),[8] which were originally published in conjunction with the Accord. Unlike the Accord, these reports were intended to provide guidance on opinion practice rather than to delineate a set of standards that could be adopted to govern an opinion. The foregoing reports, along with the 1989 Report, have become important sources of information regarding opinion practice for lawyers.[9] In 2000, the American Law Institute published the Restatement (Third) of the Law Governing Lawyers (the "Restatement"), which includes a number of sections relating to third-party legal opinions.[10]

The 1989 Report, the TriBar Report, the ABA Principles and the ABA Guidelines, as well as this Report, summarize what the drafters of those reports observe to be customary practice. Those reports and this Report are not intended to have a prescriptive effect on the standards applicable to legal opinions for purposes of liability. Nonetheless, as acknowledged by the Restatement, customary practice on such issues as the scope of diligence underlying third party opinions is articulated in bar association reports, treatises, and articles.[11]

In 2002, the Business Law Section and the Real Property Law Section of the State Bar of California published a collection of their various opinion reports (the "2002 Opinion Reports").[12]

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6 TriBar Opinion Comm., *Third-Party "Closing" Opinions*, 53 BUS. LAW. 591 (1998) [hereinafter *TriBar Report*].

7 Comm. on Legal Opinions, Section of Business Law, American Bar Association, *Legal Opinion Principles*, 53 BUS. LAW. 831 (1998) [hereinafter *ABA Principles*].

8 Comm. on Legal Opinions, American Bar Association, *Guidelines for the Preparation of Closing Opinions*, 57 BUS. LAW. 875 (2002) [hereinafter *ABA Guidelines*].

9 In January 2001, the Business Law Section of the State Bar of California issued a statement advising that the 1989 Report was out of date on some issues, and recommended that lawyers use the 1989 Report in conjunction with the Restatement, the ABA Principles, the ABA Guidelines and the TriBar Report.

10 RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS (2000) [hereinafter RESTATEMENT].

11 RESTATEMENT § 95, comment a.

12 Business Law Section & Real Property Section, State Bar of California, CALIFORNIA OPINION REPORTS (2002). The 2002 Opinion Reports include the following reports:

- Statement of the Business Law Section of the State of California (January 2001);
- 1989 Report of the Committee on Corporations of the Business Law Section of the State Bar of California Regarding Legal Opinions in Business Transactions (August 1989);
- Report Regarding Legal Opinions in Personal Property Secured Transactions (December 1988);
- Report on the Legal Opinion Report of the ABA Section of Business Law (May 1992);
- Report on Legal Opinions Concerning California Partnerships (February 1998);
- Report on Legal Opinions Concerning California Limited Liability Companies (February 2000);
- Statement of the Joint Committee of the Real Property Law Section of the State Bar of California and the Real Property Law Section of the Los Angeles County Bar Association (May 2001);
- Legal Opinions in California Real Estate Transactions;
- Legal Opinions in California Real Estate Transactions: An Addendum (March 14,1990);

(footnote continued on next page)

Even prior to that, the Business Law Section had initiated an overall project to update or replace the segments of the 2002 Opinion Reports originally prepared by standing committees of the Section, including the Committee. In that connection, the Section issued its report on Third-Party Remedies Opinions, prepared by the Section's Opinions Committee, in September 2004 (the "Remedies Report").[13] The Uniform Commercial Code Committee of the Section is in the process of updating its UCC 1988 report. This Report should be read in conjunction with the Remedies Report and the 2002 Opinion Reports, as updated.[14]

This Report is based upon California statutory and case law and the Committee's view of current opinion practice among California lawyers. Accordingly, readers are cautioned that the discussion of legal principles and suggested opinion language contained in this Report should be evaluated in light of any subsequent legislation or judicial decisions and the normal evolution of customary opinion practices.

For convenience, this Report uses the following definitions and conventions in describing opinion practice: (1) following the convention of the Remedies Report and the TriBar Report, "opinion giver" refers to the lawyer or law firm in whose name an opinion letter is signed, "opinion preparer(s)" refers to the lawyer(s) in the law firm who prepare an opinion letter, and "opinion recipient" refers to the addressee of the opinion letter and others, if any, expressly granted permission by the opinion giver to rely on the opinion letter;[15] (2) the business entity[16] that is the subject of the opinion is referred to as the "Company"; (3) the contracts and/or other written instruments evidencing obligations of the Company that the opinion addresses are collectively referred to as the "Agreement," which includes both the singular and plural as applicable to a specific situation; and (4) the list of contracts and other written instruments that are the subject of specific portions of the opinion are referred to as the "Material Agreements." As used in sample texts of opinion segments set forth in this Report, capitalized terms are "markers" for the actual corresponding term as defined in the opinion letter itself. For a glossary of the defined terms used in this Report, see Appendix A.

(footnote continued from previous page)

- 1995 California Real Property Legal Opinion Report;
- First Supplement to 1995 California Real Property Legal Opinion Report (1998);
- Inclusive Real Estate Secured Transaction Opinion in which are Incorporated the Principal Concepts of the ABA Section of Real Property, Probate and Trust Law and the American College of Real Estate Lawyers Report on Adaptation of the Legal Opinion Accord.

13 The Remedies Report is available on the Section's website at http://www.calbar.ca.gov/calbar/pdfs/sections/buslaw/opinions/2005-01_remedies-opinion.pdf.

14 The Committee's 1989 Report is superseded by this Report and the Remedies Report.

15 *See* Appendix 1 ("Glossary") to the Remedies Report.

16 Many of the specific opinions covered in this Report will be applicable to transactions undertaken by business entities other than corporations. As it relates to the form of entity and the concepts governing them, however, this Report assumes that the Company is a corporation and specifically addresses issues applicable to California corporations. Practitioners rendering opinions where the Company is a partnership or limited liability company are encouraged to consider the separate reports specifically applicable to such entities, which are included in the 2002 Opinion Reports.

I. PURPOSE OF THIS REPORT

In the years before and after the publication of the 1989 Report, commentators expressed concern about the substance, form and proliferation of written legal opinions in business transactions.[17] Concerns focused on the usefulness of opinions, the increased cost to clients of the preparation and delivery of opinion letters, and the risk of liability of lawyers rendering them.

This Report discusses the general understanding of what is meant by the term "legal opinion" in the business law context and the characteristics that distinguish legal opinions expressed in an opinion letter from informal legal advice. The principal objective of this Report is to assist lawyers in the preparation of opinion letters by examining common formats and by identifying and discussing the meanings generally ascribed to certain customarily used terms and phrases. In those instances where language customarily found in specific legal opinions is reasonably subject to differing interpretations, that fact is noted.

In addition to these general topics, this Report discusses the following issues:

1. The matters to be considered in requesting and providing opinion letters, such as guidelines for determining when and if a specific legal opinion should be requested in a particular business transaction, including cost-benefit considerations, and the appropriate content of such opinions.

2. The standard of care required under California law, with particular attention to the standard of care in rendering opinions in specialized areas of the law, such as securities law. Unresolved issues regarding the standard of care are also noted, and the Committee's view on them is sometimes presented. The Committee emphasizes that this Report is not, however, intended to establish an independent measure of the standard of care or to constitute evidence of the standard of care.[18]

3. The nature and extent of the "diligence" investigation an opinion giver customarily undertakes before issuing particular types of opinions, such as the way factual information upon which an opinion is based is obtained, determining appropriate factual assumptions to be included in the opinion letter, and analyzing the extent to which additional legal research is appropriate.

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17 *See* Appendix C, Bibliography.

18 As noted in Part III, Section A.2 of this Report, however, the Restatement looks to Bar reports such as this Report for guidance on the standard of care applicable to lawyers for purposes of establishing the lawyer's discharge of his or her duty of care. For a discussion of standard of care issues in rendering securities law opinions, *see* Part V, Section E of this Report.

The most common context in which an opinion letter is given is to a third party at the request of a client. In that context, the opinion letter is typically referred to as a "third-party legal opinion" or, if given at the closing of a business transaction, a "closing opinion."[19] This Report addresses the giving of third-party legal opinions by California lawyers, including opinion letters nominally requested by and addressed to the client, but intended by the opinion giver to be relied on by a third party, such as the legal opinion ("Exhibit 5 opinion") rendered by securities counsel to their client in connection with an offering of securities registered under the Securities Act of 1933 (as amended, the "1933 Act").[20]

Lawyers may also from time to time be asked to render a legal opinion to their own clients. For example, a financial institution may request not only a closing opinion from borrower's counsel, but also a legal opinion from its counsel. As another example, a client may request a tax opinion from its counsel to provide a basis for the avoidance of penalties if the tax aspects of a transaction are later challenged by the Internal Revenue Service.[21]

While an opinion giver must exercise due care in rendering an opinion letter, whether addressed to a third party or to the opinion giver's client, other considerations apply when an opinion is rendered to a lawyer's own client.[22] As the commentary to Section 95 of the Restatement (addressing opinions to third parties) notes, a third-party recipient of a lawyer's opinion "does not thereby become the client of the lawyer, and the lawyer does not thereby undertake all duties owed to a client, such as confidentiality or avoidance of conflicting interests . . . ."[23] Moreover, in rendering a third-party legal opinion, "a lawyer does not undertake to advise the third person except with respect to the questions actually covered by the evaluation [opinion]."[24]

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19 *See generally* James Fuld, *Legal Opinions in Business Transactions—An Attempt to Bring Some Order Out of Some Chaos*, 28 BUS. LAW. 915 (1973) [hereinafter Fuld].

20 Securities Act of 1933, 15 U.S.C. §§ 77a – 77aa. *See* Special Report of the Task Force on Securities Law Opinions of the ABA Section of Business Law, *Legal Opinions in SEC Filings*, 59 BUS. LAW 1505 (2004) [hereinafter *SEC Filings Report*].

21 *See* Jasper Cummings, Jr., *The Range of Legal Tax Opinions, With Emphasis on the "Should" Opinion*, TAX NOTES 1125 (February 17, 2003).

22 *See* RESTATEMENT § 16 and § 95, comment c. Section 16 of the Restatement outlines the duties of a lawyer to his or her client, which duties include the obligation to proceed "in a manner reasonably calculated to advance a client's lawful objectives, as defined by the client after consultation," the obligation to "act with reasonable competence and diligence," the obligation to "comply with obligations concerning the client's confidences and property, avoid impermissible conflicting interests, deal honestly with the client, and not employ advantages from the client-lawyer relationship in a manner adverse to the client," and to "fulfill valid contractual obligations to the client." *See also* CAL. BUS. & PROF. CODE § 6068(e) (lawyer to "maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client").

23 *See* RESTATEMENT § 95, comment c.

24 *Id.* Arthur Norman Field observes that "[a]ny opinion letter to the client likely represents only one aspect of the lawyer's duty to the client." Arthur Norman Field, LEGAL OPINIONS IN BUSINESS TRANSACTIONS § 15:1 (2004) [hereinafter FIELD TREATISE]. Field discusses legal opinions to clients in chapter 15 of his treatise.

Accordingly, except as specifically noted, this Report does not address the separate considerations that may be relevant when an opinion giver is rendering an opinion to its client, and references in this Report to "opinions" are to third-party opinions.

Finally, Appendix B to this Report lists the authorities cited in this Report and Appendix C contains a bibliography of articles and other publications on the subject of legal opinions and related topics.

II. DEFINITION AND PURPOSE OF A LEGAL OPINION

Commentators have defined the term "opinion" in a variety of ways, depending upon the context in which it is used.[25] In business transactions, a legal opinion regarding a particular issue is customarily presented in an opinion letter and is widely understood to express the opinion giver's professional understanding of the legal principles generally applicable to a specific transaction or applicable to a particular aspect of the transaction.[26] Many commentators view an opinion letter as a document that provides the opinion recipient with the opinion giver's professional judgment about how the highest court of the jurisdiction whose law is being addressed would resolve the issues covered by the opinion letter on the date of the opinion.[27] It is widely recognized that neither an opinion letter nor any particular legal opinion expressed in it is intended to be -- or is -- a guarantee of a particular outcome.[28]

Some of the more common reasons for the preparation and delivery of an opinion letter include the following:

1. To address whether an intended course of action is lawful or that certain desirable legal consequences will follow from an intended course of action (or, conversely, that certain legal consequences will not result from the proposed course of action);

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25 For instance, Webster's Third New International Dictionary defines an opinion as "a formal expression by an expert (as a professional authority) of his thought upon or judgment or advice concerning a matter." Webster's Third New International Dictionary 1582 (1964). With respect to opinions in the legal context, Black's Law Dictionary refers to "[a] written document in which an attorney provides his or her understanding of the law as applied to assumed facts." BLACK'S LAW DICTIONARY 1120 (8th ed. 2004). In the current customary usage, that definition would correspond to the "opinion letter."

26 As stated in the ABA Guidelines, discussing the closing opinion, the opinion provides "the recipient with the opinion giver's professional judgment on legal issues concerning the opinion giver's client, the transaction, or both, that the recipient has determined to be important in connection with the transaction." *ABA Guidelines* § 1.1.

Where the lawyer is a member of a law firm, the opinion is typically rendered by and in the name of the firm itself (the "opinion giver"), rather than by an individual lawyer, who is an "opinion preparer." *See Remedies Report*, Appendix 1 ("Glossary"); *TriBar Report* § 1.8. As noted in the Remedies Report, in the definition (Appendix 1) of "opinion preparers," if a particular lawyer takes responsibility for a specific opinion within the opinion letter, then that lawyer is an "opinion preparer" only as to that opinion and not as to all other opinions in the opinion letter.

27 *See* RESTATEMENT § 95 comment c; *TriBar Report* § 1.2.

28 Smith v. Lewis, 13 Cal. 3d 349, 358, 118 Cal. Rptr. 621, 627 (1975). *See* RESTATEMENT § 52, comment b; *ABA Principles* § I.D.

2. To satisfy contractual requirements -- *e.g.*, an opinion given by issuer's counsel to investors in connection with the sale of securities or by borrower's counsel to the lender pursuant to a loan agreement;

3. To satisfy regulatory requirements -- *e.g.*, an opinion given in connection with the qualification of securities under the California Corporate Securities Law of 1968[29] (as amended, the "CSL") or their registration under the 1933 Act; and

4. To resolve questions raised by other professionals and to provide an authoritative basis for statements, reports and opinions with respect to matters on which other professionals are not qualified to make judgments -- *e.g.*, an opinion regarding local law provided to out-of-state counsel.

Lawyers and clients often cite due diligence as the principal reason for requesting opinion letters in business transactions. An opinion letter may be one component of a party's due diligence, but it should not normally be used as a substitute for due diligence performed by the opinion recipient (whether a party to the transaction or a third party that plays a key role in its consummation) and its counsel. While the opinion recipient generally has no affirmative responsibility to conduct due diligence to determine whether an opinion is accurate,[30] receipt of an opinion letter is not a substitute for the diligence that the opinion recipient should conduct in a transaction such as, for example, the investigation and related procedures that would provide an underwriter with a due diligence defense under Section 11 of the 1933 Act. Moreover, an "opinion recipient has no right to rely on an opinion if reliance is unreasonable under the circumstances or the opinion is known by the opinion recipient to be false."[31]

III. LEGAL STANDARDS APPLICABLE TO PREPARATION OF AN OPINION

A. Standard of Care

1. Generally

A lawyer is expected to be well informed and to exercise "such skill, prudence and diligence as lawyers of ordinary skill and capacity commonly possess and exercise in the performance of the tasks which they undertake."[32] Restatement Section 52 states that "a lawyer

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29 CAL. CORP. CODE §§ 25000 – 25707.

30 *See TriBar Report* § 1.6; *ABA Principles* § I.E; FIELD TREATISE § 3.9. *But see* Greyhound Leasing & Fin. Corp. v. Norwest Bank, 854 F.2d 1122 (8th Cir. 1988) (under North Dakota law, a lender's own negligence in not investigating lien status precludes a negligence claim against the opinion giver who relied solely upon a client's representations without conducting a lien search).

31 *TriBar Report* § 1.6.

32 Lucas v. Hamm, 56 Cal. 2d 583, 591, 15 Cal. Rptr. 821, 825, *cert. denied*, 368 U.S. 987 (1961) (finding lawyer not liable for a violation of the rule against perpetuities because a lawyer of ordinary skill in similar circumstances might have made a similar error); Betts v. Allstate Ins. Co., 154 Cal. App. 3d 688, 715, 201 Cal. Rptr. 528, 544 (1984). *See also* RESTATEMENT (SECOND) OF THE LAW OF TORTS § 299A (1965) ("Unless he represents that he has greater or less skill or knowledge, one who undertakes to render services in the practice of a profession or trade is required to exercise the skill and knowledge normally possessed by members of that profession or trade in good standing in similar communities."). The California Rules of

(footnote continued on next page)

who owes a duty of care must exercise the competence and diligence normally exercised by lawyers in similar circumstances."[33] When a matter falls within a recognized area of legal specialty, such as tax or securities law, a more stringent "prudent expert rule" is generally applied.[34]

2. Customary Practice

The Restatement's articulation of the lawyer's duty of care as consisting of the "competence and diligence normally exercised by lawyers in similar circumstances" naturally calls for an examination of "customary practice" in assessing the lawyer's conduct; that is, the care that a competent lawyer, exercising customary diligence, would exercise in similar circumstances. Since the 1989 Report was published, a large body of commentary has developed describing customary practice in the preparation and interpretation of third-party opinion letters.[35] This commentary, including this Report and the Remedies Report, may be consulted for

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Professional Conduct (the "Rules of Conduct") state the obligation in the negative: "A member shall not intentionally, recklessly, or repeatedly fail to perform legal services with competence." Rule 3-110(A). "Competence" in any legal services is defined to mean the diligence, learning and skill, and mental, emotional, and physical ability reasonably necessary for performance of such service. Rule 3-110(B).

33 Under the Restatement, a lawyer owes a duty to use care to certain nonclients, including a nonclient when and to the extent that "the lawyer or (with the lawyer's acquiescence) the lawyer's client invites the nonclient to rely on the lawyer's opinion or provision of other legal services, and the nonclient so relies.…" RESTATEMENT § 51(2)(a).

34 When a legal matter falls within an officially or commonly recognized legal specialty, courts have imposed a duty on the lawyer to refer the client to a specialist (or to recommend a specialist) "if under the circumstances a reasonably careful and skilled lawyer would do so." Horne v. Peckham, 97 Cal. App. 3d 404, 414, 158 Cal. Rptr. 714, 720 (1979). Note that *Horne* was overruled on other grounds by *ITT Small Business Corp. v. Niles*, 9 Cal. 4th 245, 36 Cal. Rptr. 2d 552 (1994), which was overruled four years later by *Jordache v. Brobeck, Phleger & Harrison*, 18 Cal. 4th 739, 76 Cal. Rptr. 2d 749 (1998). Rule 3-110(C) of the Rules of Conduct provides that if a member does not have sufficient learning and skill when the legal service is undertaken, then the member may nonetheless perform such services competently by (i) associating with or, where appropriate, professionally consulting another lawyer reasonably believed to be competent, or (ii) by acquiring sufficient learning and skill before performance is required. Lawyers rendering advice with respect to matters falling within a recognized legal specialty have been judged by the standard of whether they possessed the knowledge and skill ordinarily possessed, and whether they exercised the case and skill ordinarily used, by a specialist in similar circumstances. *See Horne*, 97 Cal. App. 3d at 414; *see also* Wright v. Williams, 47 Cal. App. 3d 802, 809, 121 Cal. Rptr. 194, 199 (1975). If due care is exercised in referring to a specialist, the referring lawyer should have no liability as a result of the specialist's negligent actions. *See also* comment d to RESTATEMENT § 52.

35 *See TriBar Report; ABA Principles; ABA Guidelines;* TriBar Opinion Committee, *Special Report of the TriBar Opinion Committee*: *The Remedies Opinion – Deciding When to Include Exceptions and Assumptions*, 59 BUS. LAW. 1483 (2004); *SEC Filings Report*; Special Report of the Task Force on Securities Law Opinions, ABA Section of Business Law, *Negative Assurance in Securities Offerings*, 59 BUS. LAW. 1513 (2004) [hereinafter *Negative Assurance Report*]*;* Committee on Legal Opinions, ABA Section of Business Law, *Law Office Opinion Practices*, 60 BUS. LAW. 327 (2004); Donald W. Glazer, Scott FitzGibbon & Steven O. Weise, GLAZER AND FITZGIBBON ON LEGAL OPINIONS*:* DRAFTING, INTERPRETING AND SUPPORTING CLOSING OPINIONS IN BUSINESS TRANSACTIONS (2d ed. 2001) [hereinafter GLAZER & FITZGIBBON].

guidance on customary practice in the preparation and interpretation of legal opinions.[36] The Remedies Report contains an extensive discussion of the role of customary practice in preparing and interpreting the remedies opinion.[37]

However, there is currently no case law authority in California that definitively establishes customary practice as the touchstone by which to measure the due care exercised by an opinion giver in rendering a legal opinion. An examination of customary practice would appear to be called for by the Supreme Court's reference in *Lucas v. Hamm* to the "diligence as lawyers of ordinary skill and capacity commonly possess and exercise in the performance of the tasks which they undertake."[38] It is reasonable to expect that a California court examining the duty of care applicable to an opinion giver subject to the laws of California would give weight to the analysis and conclusions of commentaries regarding the role of customary practice.

In *Smith v. Lewis*, a 1975 decision, the California Supreme Court upheld a jury verdict of negligence against a family law lawyer for wrongly advising his client that her husband's retirement benefits were not community property.[39] In upholding the jury's verdict, the Court (over the dissent of Justice Clark) articulated the lawyer's duty as follows:

> As the jury was correctly instructed, an attorney does not ordinarily guarantee the soundness of his opinions and, accordingly, is not liable for every mistake he may make in his practice. He is expected, however, to possess knowledge of those plain and elementary principles of law which are commonly known by well informed attorneys, *and to discover those additional rules of law which, although not commonly known, may readily be found by standard research techniques*.[40]

The italicized language would be troubling if it were read to require an opinion giver to go beyond what customary practice would entail in conducting legal diligence in the preparation of a legal opinion: with electronic databases and the Internet, and with the right query to the right database, a first year law student might "readily" find virtually any law, rule, regulation, case or administrative decision. The test of the care exercised by an opinion giver in rendering an opinion should not be what the opinion giver *could* have found but what a competent lawyer, exercising customary diligence, *would* have found.[41]

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36 The Reporter of the Restatement, Professor Wolfram, cites this commentary as having been "instrumental in furthering understanding of the evaluation process and contributing to uniformity in practice among lawyers issuing legal opinions." RESTATEMENT § 95, Reporter's Note, comment b.

37 *See* Appendix 8 ("Application of Customary Practice to the Remedies Opinion") to the Remedies Report.

38 *See* note 32.

39 Smith v. Lewis, 13 Cal. 3d 349, 118 Cal. Rptr. 621 (1975).

40 13 Cal. 3d at 358, 118 Cal. Rptr. 627 (emphasis added). *See also* Stanley v. Richmond, 35 Cal. App. 4th 1070, 1092, 41 Cal. Rptr. 2d 768, 780 (1995).

41 For the Remedies Report's analysis of Smith v. Lewis, *see* Appendix 8, Section III.B.2 to the Remedies Report.

This Report provides guidance on customary practice for opinion givers governed by California law in preparing and delivering legal opinions on the topics addressed.[42] The Committee has not independently evaluated the role that customary practice would play in court in establishing an opinion giver's due care in rendering an opinion letter. That evaluation is beyond the scope of this Report. The reader is invited to review Appendices 5 and 8 of the Remedies Report for such an evaluation.

The opinion preparers should devote the time needed to interpret and apply legal principles relevant to the situation at hand, ascertain (through appropriate inquiry and certificates of officers of the Company) the facts that underlie the opinion, and identify areas of significant uncertainty (if any) in the interpretation and application of legal principles. In certain cases, opinion givers may conclude that it is necessary to conduct research with respect to particular legal principles or to conduct an investigation of the underlying facts relevant to the opinion. Early consideration of the opinions requested will also afford the opinion preparers a better opportunity to identify potential problem areas and to negotiate an appropriate form of opinion or, if appropriate, to modify the structure or terms of the transaction.

B. Fraudulent or Misleading Opinions

An opinion giver may be liable for an opinion that constitutes fraudulent misrepresentation. A lawyer owes a duty to nonclients to refrain from fraudulent misrepresentation.[43] One recent California case looked to the Restatement to identify obligations of lawyers to refrain from knowingly making false statements on behalf of a client.[44]

It is generally understood that, regardless of compliance with other standards, and even if an opinion is technically correct, a lawyer should not render an opinion that the lawyer recognizes would be misleading to the opinion recipient.[45]

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42 Based upon its review of the TriBar Report and the other bar association reports referred to in this Report, the Committee believes that the customary practice it describes in this Report as followed by California practitioners is substantially similar to national customary practice.

43 *See* Cicone v. URS Corp., 183 Cal. App. 3d 194, 120-21, 227 Cal. Rptr. 887, 890-91 (1986) (holding a lawyer liable to a non-client for intentionally tortious fraudulent statements without the duty or public policy limitations of a negligence claim); Shafer v. Berger, Kahn, Safton, Moss, Figler, Simon & Gladstone, 107 Cal. App. 4th 54, 131 Cal. Rptr. 2d 777 (2003) (allowing a claim against a lawyer by non-clients for fraudulent misrepresentation); Vega v. Jones, Day, Reavis & Pogue, 121 Cal. App. 4th 282, 17 Cal. Rptr. 3d 26 (2004) (finding law firm for buyer of company in merger transaction could be liable to seller based on allegations that law firm "actively conceal[ed]" information from seller after undertaking to disclose information). *See also* William Freivogel, *The Ethics and Lawyer Liability Issues Raised by Third-Party Opinion Letters* 228-29, 230-32 (Practising Law Institute, Corporate Law and Practice Course Handbook Series, PLI Order No. B0-002V, 1998) (indicating the biggest risks in issuing opinions, based on settled malpractice claims, are client fraud and conflict of interest).

44 *See Shafer*, 107 Cal. App. 4th 54, 131 Cal. Rptr. 2d 777 (2003) ("A lawyer communicating on behalf of a client with a nonclient may not … knowingly make a false statement of material fact … to the nonclient.") (ellipses in original) (quoting RESTATEMENT § 98).

45 *See* Roberts v. Ball, Hunt, Hart, Brown & Baerwitz, 57 Cal. App. 3d 104, 128 Cal. Rptr 901 (1976). In this case the Court of Appeal reviewed a judgment of dismissal entered by the trial court, following its granting of defendants' demurrer. The Court of Appeal reversed the judgment. Plaintiff alleged that the defendant

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C. Ethical Issues Relating to the Provision of Opinions to Nonclients

A lawyer delivering an opinion letter to a nonclient should also consider ethical principles. For example, rendering an opinion to a nonclient may conflict with the opinion giver's ethical obligations to maintain the confidences of its client. No California ethical rule directly addresses the giving of legal opinions to third parties, but California has strict rules regarding preservation of client confidences.[46]

The 2002 ABA Model Rules of Professional Conduct (the "ABA Model Rules") and the Restatement set forth similar standards for providing "evaluations" to third parties. A legal opinion to a third party is considered an evaluation for purposes of the ABA Model Rules and the Restatement. Rule 2.3 of the ABA Model Rules permits a lawyer to provide an evaluation for a nonclient's use when the lawyer reasonably believes that making the evaluation is compatible with other aspects of the lawyer's relationship with the client.[47] Section 95 of the Restatement states that a lawyer may provide a professional evaluation or an opinion to a nonclient in furtherance of the objectives of a client in that representation. Both the ABA Model Rules and the Restatement require, however, that a lawyer obtain the client's informed consent if the evaluation is reasonably likely to affect the client's interests materially and adversely.[48]

As a practical matter, third-party opinion letters are typically negotiated by the lawyers for the parties rather than by their respective clients. A lawyer should always consider whether

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law firm had rendered an opinion to a general partnership, at the partnership's request, with the knowledge that the opinion would be shown to plaintiff, a prospective creditor of the partnership. The firm rendered its opinion that the partnership was a duly organized general partnership, consisting of 14 individuals who were general partners of the partnership. Plaintiff alleged that (i) at the time the opinion was rendered, the firm knew that a large number of the partners did not believe the partnership to be a general partnership, and (ii) the firm failed to disclose this knowledge to plaintiff. Under these alleged facts, the Court found that plaintiff had stated a cause of action for negligent misrepresentation:

> Even though defendants may have believed that there was a general partnership in spite of the claims of some of the general partners, the firm had a duty to reveal to plaintiff this doubt as to the status of the partnership as a general partnership, since the firm knew that disclosure of this doubt might well be determinative of plaintiff's decision to make loans to [the partnership].

57 Cal. App. 3d at 111.

The *Ball Hunt* case is now generally understood to stand for the proposition that a lawyer may not render a misleading opinion. *See also TriBar Report* §§ 1.4(d), 1.9(m); *ABA Guidelines* § 1.5.

46 All California lawyers should be sensitive to the requirements of Business and Professions Code Section 6068(e), which requires a California lawyer to maintain client secrets "at every peril to himself or herself." CAL. BUS. & PROF. CODE § 6068(e). The closest comparable provisions of the Model Rules of Professional Conduct are found in Rule 1.6, but that rule is primarily useful to California lawyers only to demonstrate obligations that are subsumed within Business and Professions Code Section 6068(e). *See* MODEL RULES OF PROF'L CONDUCT R. 1.6.

47 MODEL RULES OF PROF'L CONDUCT R. 2.3.

48 *See also* MODEL RULES OF PROF'L CONDUCT R. 2.3; RESTATEMENT § 95. The Rules of Conduct (as amended through July 1, 2004) have no counterpart to Model Rule 2.3 or Restatement § 95. *See* CAL. RULES OF PROF'L CONDUCT (2004).

rendering an opinion will lead to the disclosure of sensitive or confidential information about the client. The opinion giver should consult with the client and obtain the client's consent before disclosing confidential information to a third party.[49]

D. Inside Lawyers

An "inside" or "in-house" lawyer is one who is an employee of either the company for whom the opinion is delivered or an affiliated company. Inside lawyers often render opinions in business transactions. An inside lawyer is subject to the same standard of care as outside counsel. An inside lawyer signing an opinion letter acts not as an officer or employee of the Company but as an individual lawyer subject to the professional standards applicable to all lawyers. Inside lawyers may therefore wish to evaluate the indemnification and insurance policies of their employers before giving legal opinions.[50]

IV. PREPARATION OF THE OPINION LETTER

A. Preliminary Considerations

Before agreeing on the opinion to be rendered in a particular business transaction, the lawyers representing the principals should carefully consider the size, nature and scope of the transaction and the legal issues relevant to it. The opinion giver should also consider whether giving the opinion will create a conflict with its representation of existing clients.[51]

Generally, an opinion should not be requested or rendered on non-material matters,[52] on laws of states or foreign countries with which the lawyer is not familiar, or on issues for which the opinion must be so qualified that it is of little value to the recipient. This Report discusses several (but not all) instances in which, in the Committee's view, it is generally inappropriate to request and, if requested, it would generally be appropriate to decline to render, a particular form of opinion,[53] including for reasons of cost effectiveness.[54] As a threshold matter, counsel for the opinion recipient should consider whether it would agree to furnish the opinion if requested to do

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49 *See* Appendix 4 ("Report of Threshold Committee") to the Remedies Report, Section II(B), discussing certain ethical issues in the context of remedies opinions.

50 *See* Comm. on Legal Opinions, American Bar Association, *Closing Opinions of Inside Counsel*, 58 BUS. LAW. 1127 (2003); Carolyn Harris, *Personal Liability for In-House Legal Opinions—Is it Worth the Risk*, BUS. LAW NEWS, Volume XXII, Issue 2 (2003).

51 *See* Part III, Section D of this Report. *See also* Appendix 4 ("Report of the Threshold Subcommittee") to the Remedies Report at Part I, Section B; *ABA Guidelines* § 2.4.

52 Other considerations regarding limitations on the scope of an opinion letter are set forth in Appendix 4 ("Report of the Threshold Subcommittee") to the Remedies Report at Part IV. The measure of "materiality" may be an issue in and of itself within one or more of the opinions being requested. Lawyers should use great care in evaluating the materiality of an item and recognize that the cumulative effect of several items may become material or have a material effect on the opinion. Furthermore, materiality may not have the same analytical significance in the context of each opinion for which the term may be used.

53 *See* Part IV, Section B of this Report.

54 *Id*. *See also* Appendix 4 ("Report of the Threshold Subcommittee") to the Remedies Report which includes examination of issues which should be considered in this context.

so in a similar transaction. This principle is often referred to as the "Golden Rule" of opinion practice.[55]

If counsel disagree on the propriety of a requested opinion, the matter should be resolved early in the transaction.

For further discussion of when it is and is not appropriate to request a legal opinion, specifically a remedies opinion, see the Remedies Report, Appendix 4 ("Report of the Threshold Subcommittee").

B. Problem Areas and Inappropriate Subjects for Opinion Requests

Differences between opinion givers and opinion recipients generally arise over (1) the time and expense required to render an opinion on a matter that is peripheral to the transaction or to the primary concerns of the opinion recipient, (2) the appropriate scope of a particular opinion, (3) whether the opinion will cover matters that are essentially factual in nature, (4) whether the opinion will cover matters about which there is some recognized legal uncertainty, and (5) requests for what historically were referred to as "comfort opinions" but are more properly referred to as "negative assurances." In addition to "problem areas" of specific opinions addressed elsewhere in this Report,[56] this Section addresses "problem areas" in general.

1. Opinions That Are Not Cost-Effective

As discussed in Part III of this Report, opinion givers are held to certain standards of skill and care in rendering legal opinions. Although the nature and extent of the applicable standards of care are not clearly defined, the opinion giver is obligated to avoid misleading opinion recipients about the scope and depth of any investigation undertaken.[57] Moreover, lawyers are responsible for conducting customary legal and factual diligence in rendering legal opinions. For this reason, rendering an opinion letter may be a costly process, even in the context of a relatively straightforward business transaction. In determining whether a particular opinion is appropriate under the circumstances and, if so, what the nature and scope of that opinion should be, the opinion giver must consider the costs of giving the opinion relative to the benefits to the client of satisfying the request of the opinion recipient.

In many cases, the opinion recipient should be satisfied by its own lawyer's review and advice and should refrain from requesting an opinion from counsel for the other party to the transaction. Moreover, this often is more cost-effective because the lawyer for the opinion recipient usually is more familiar with the documentation. Lawyers asked to render an opinion requiring costly preparation typically inform their client at the outset about the issues presented by the request. Unless otherwise instructed by its client, the opinion giver often attempts to limit the opinion in appropriate circumstances, for example when the opinion involves substantial factual investigation or legal principles not within the expertise of the opinion giver.

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55 *See ABA Guidelines* § 3.1.

56 *See* Part VII of this Report.

57 *See* Part IV, Section D.3 of this Report (investigation of factual issues).

To avoid unnecessary costs in preparing an opinion, the opinion giver should carefully review the proposed draft opinion (often prepared by opposing counsel) and resist acquiescing to opinions on matters that are peripheral to the transaction at hand. An example of an opinion that often is not cost-effective in a typical transaction is an opinion that all of the issued and outstanding shares of capital stock of the client have been duly authorized and validly issued and are fully paid and nonassessable.[58]

Opinions of this sort may require legal conclusions that are heavily dependent on a complex set of facts and circumstances or the assistance of special counsel in areas in which the opinion giver is not competent. If the scope of the opinion is not limited, then unrealistic burdens may be placed on the opinion giver.

If the opinion recipient is concerned about a significant legal issue, it may be appropriate to insist that the opinion giver undertake the necessary legal investigation to render an opinion on that specific issue, assuming it is practical and customary to give such an opinion. The matter then becomes the subject of negotiation.

Opinions may be made less burdensome and therefore more appropriate if narrowed in scope. For example, opinions that a particular transaction does not violate specified laws or specified contracts are common. However, the time and financial resources of the parties and their counsel often are better served by appropriate representations and warranties in the underlying agreement and by the concerned party conducting its own due diligence investigation.[59]

Often, the parties attempt to lessen the burden by allowing the opinion giver to base the opinion upon its "best knowledge" or "current actual knowledge," phrases typically intended to indicate that the opinion giver has not engaged in any factual investigation beyond the facts known to the opinion giver. Generally for such qualifications to be effective in limiting the opinion giver's obligation to exercise customary diligence in rendering an opinion, the opinion giver will include an express statement describing the factual investigation it conducted on a particular point and making clear that no other investigation was conducted. A knowledge qualifier, however, will not generally render an overbroad opinion appropriate because it is properly used only with respect to factual diligence.[60]

2. Inappropriate Scope

The Committee believes that a number of opinions that were relatively common when the 1989 Report was issued would now be considered inappropriate because their scope is not

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58 *See* Appendix 4 ("Report of the Threshold Subcommittee") to the Remedies Report (for a discussion of the issue of cost-effective remedies opinions). *See also* Part V, Section D.6 of this Report.

59 With respect to the more limited request for an opinion regarding specified (or a limited set of) laws, regulations and rulings, *see* Part V, Section C.4 of this Report. With respect to the more limited request for an opinion regarding specified (or a limited set of) contracts, indentures or undertakings, *see* Part V, Section C.2 of this Report. With respect to the more limited request for an opinion regarding shares of capital stock to be issued in a specified transaction, *see* Part V, Section D.3 of this Report.

60 *See* Part IV, Section D.3 of this Report, and note 259 and accompanying text.

reasonably within the competence of the opinion giver or they are not cost-justified. Examples of such opinions include the following:

- the client is qualified to do business as a foreign corporation in all jurisdictions in which its property or activities require qualification or in which the failure to qualify would have a material adverse effect on the client;

- the client is not in material violation of any federal, state or local law, regulation or administrative ruling; and

- the client is not in material violation of any contract, indenture or undertaking to which it is a party or by which it may be bound.[61]

The common characteristic of these examples is that they are essentially open-ended. Requests for opinions of this sort inherently cast into question whether the party requesting the opinion may be effectively seeking legal "insurance" rather than legal "assurance." The Committee believes that an opinion giver may properly refuse to give such opinions.

3. Confirmations of Fact; Negative Assurance

When the 1989 Report was issued, it was relatively common to refer to certain statements of fact included in opinion letters as "factual opinions." As a result of the substantial commentary that has occurred since then, parties to business transactions (and their lawyers) recognize that statements of a factual nature are not properly labeled as "opinions" but instead are actually "confirmations" of facts that may or may not be known to the opinion recipient but that do not, in any sense, constitute a "legal opinion."[62] Opinion givers should take care that the opinion letter makes a clear distinction between those portions that constitute actual opinions on matters of law and other portions (including confirmations of a purely factual nature) that do not.

Opinion givers generally decline to provide confirmations of purely factual matters. Although often characterized as an opinion, these confirmations in essence ask the opinion giver to express a view not founded on professional competence. The function of a legal opinion is to provide informed judgments on matters of law, not assurance regarding factual statements that the parties to a transaction are in a better position to verify. As stated in the ABA Guidelines:

> An opinion giver normally should not be asked to state that it lacks knowledge of particular factual matters. Matters such as the absence of prior security interests or the accuracy of the representations and warranties in an agreement . . . do not require the exercise of professional judgment and are inappropriate subjects for a legal opinion even when the opinion is limited by a broadly worded disclaimer.[63]

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61 *See ABA Guidelines* §§ 4.1, 4.3: Part IV, Section B.2 of this Report.

62 This is consistent with the plain meaning of the words, an important factor in identifying customary usage of terms.

63 *ABA Guidelines* § 4.4.

Two exceptions are generally recognized to the practice of not providing factual confirmations: a confirmation regarding the opinion giver's knowledge of legal proceedings to which its client is a party; and negative assurance in certain contexts on the adequacy of the disclosure in a prospectus or other disclosure document furnished to investors in connection with a sale of securities.

Knowledge of Legal Proceedings. An opinion giver may be asked to state that, to its knowledge, no claims or legal actions are pending or threatened in writing against the client except as set forth on an exhibit to the Agreement.[64] Although the requested statement is factual in nature, some lawyers believe that lawyers representing clients in business transactions may have heightened knowledge of pending or threatened legal actions or have the ability to verify the existence or nonexistence of such matters readily from the client's records. Again, the appropriateness of including these confirmations of fact in an opinion letter depends on the circumstances. Consistent with this approach, most lawyers take the position (supported by the Committee) that statements as to factual matters should not be viewed as "opinions" as they do not express a legal conclusion, and therefore refuse to provide them absent clarifying language that they are limited to statements of "knowledge" or "belief" of the opinion giver as to specified factual matters.[65] The Committee believes that an opinion giver may properly refrain from including any such confirmations of fact within the portion of an opinion letter that contains the legal opinions and instead provide them in an identifiably separate portion of the opinion letter in which all factual confirmations are presented or include them in a separate letter addressed to the opinion recipient.

The Committee believes that opinion givers generally should not be asked for opinions on the outcome of pending or threatened claims or legal actions.[66] Although an argument might be made that a "negative assurance" statement (discussed in detail below) provided by a lawyer in connection with a securities offering implicitly includes this type of conclusion if the disclosure document includes a statement by the issuer/client of the potential outcome of a particular litigation matter, the Committee believes that it is generally understood that it does not.[67]

Negative Assurance. When the 1989 Report was issued, it was relatively common to refer to a statement included in an opinion letter as to the absence of belief or knowledge of misstatements or omissions in certain disclosure documents as a "comfort opinion." To a certain extent, that terminology continues to be used, although with increasing frequency it refers to such a statement in a separate letter from the opinion giver and thus is more often referred to as a

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64 The Committee's formulation of this form of negative assurance uses the qualifier "in writing" to claims or legal actions not filed but "threatened." *See* Part V, Section C.8 of this Report. Of course, as *Ball Hunt* teaches, such a formulation of the negative assurance would be inappropriate if the opinion preparers have knowledge of a threatened claim or legal action that is material to the client. *See* Part III, Section B of this Report, and note 45.

65 For customary practice in defining "knowledge" or "belief" when used in factual confirmations, *see* "Limitations on the Basis of Knowledge" in Part IV, Section D.4 of this Report.

66 *See ABA Guidelines* § 4.7. *See also* Part V, Section C.8 of this Report.

67 *See* Part V, Section C.8 of this Report.

"comfort letter." Another change that has resulted from substantial commentary since the issuance of the 1989 Report is the characterization of these statements as "negative assurance" statements. As with confirmations (formerly called "factual opinions"), such statements are not actually legal opinions at all but rather statements of knowledge or belief of the lawyer or firm providing the "negative assurance." The Committee believes that it increasingly is customary for lawyers (as well as opinion recipients and their counsel) not to use the term "comfort opinion"[68] but to refer to such a statement as a "negative assurance."[69]

In a "negative assurance" statement, the opinion giver states that, based upon its participation in the matter at issue, it is not aware of any misstatement or omission in the disclosure document of its client. The opinion giver providing the "negative assurance" generally expresses limitations on the scope of the statement by the use of introductory language describing its role in the transaction and the extent of its investigation or independent verification of facts. The Committee believes that it is consistent with opinion practice for such qualifications to appear in the text of an opinion letter as well as in any accompanying documents describing the opinion letter or its contents and likely to be viewed by other parties to the transaction. The Committee supports the growing practice of providing "negative assurance" (if they are to be given) in a separate letter rather than in the text of an opinion letter.[70]

There are certain limited and specialized situations in which lawyers typically provide "negative assurance". In securities underwritings involving publicly held companies, the lawyers providing "negative assurance" will typically have participated in the preparation of the Company's registration statement filed with the Securities and Exchange Commission ("SEC").[71]

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68 As to certain securities law matters described below in this subsection, it was also called a "Rule 10b-5 opinion" and occasionally still is. The Committee believes that use of the term "Rule 10b-5 opinion" should also be discontinued.

69 *See* note 70.

70 In its *Negative Assurance Report*, the Task Force on Securities Law Opinions, ABA Section of Business Law, states that the negative assurance given in securities law opinions is typically provided in a separate letter or in a separate unnumbered paragraph of a closing opinion. "Either way, counsel's responsibility and the meaning of the negative assurance are the same." *Negative Assurance Report*, 59 BUS. LAW. at 1516.

To avoid any possible misunderstanding as to the scope of "negative assurance," the opinion letter typically includes statements that the lawyer is not assuming any responsibility for the contents of the documents mentioned in the prospectus or offering document, except for certain limited portions as expressly stated in the letter, and that the lawyer disclaims any opinion with respect to financial statements and other financial or statistical data.

71 As observed in note 25, the entry in Black's Law Dictionary for "opinion" has undergone substantial expansion since the 1989 Report. This expansion includes the addition of a definition of "comfort opinion" which, in the current edition (8th ed. 2004), is specifically limited to securities law matters and defined as "[a]n attorney's written opinion that there is no reason to believe that a registration statement contains any material misrepresentations or omissions that would violate § 11 of the Securities Act of 1933." The concept of the "comfort opinion" has expanded to other areas of the law. The Committee supports the position implicit in the ABA Guidelines that opinion givers would be fully justified in refusing to provide "negative assurance" in any context other than matters involving the registration of securities under the 1933 Act and certain types of unregistered offerings (e.g., some Rule 144A and Regulation S offerings). *See ABA Guidelines* § 4.5; *Negative Assurance Report*, 59 BUS. LAW. at 1513-1514.

The lawyer typically confirms to the recipient of the "negative assurance" statement, based upon this participation, the following:

> Nothing has come to our attention that has led us to believe that the [disclosure document] contains an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements therein [, in the light of the circumstances under which they were made,] not misleading.

An opinion giver providing "negative assurance" typically qualifies it with a statement of the extent of, or more typically, the absence of the opinion giver's independent verification of the facts.[72] As a general rule, the Committee believes that it is inadvisable for an opinion giver to provide negative assurance other than to a recipient to assist the recipient in establishing a "due diligence" defense to a claim of liability based on the adequacy of the disclosure made as part of such transaction.[73]

4. Opinions Regarding Issues of Significant Legal Uncertainty

A fourth common area of disagreement involves legal issues that, although potentially appropriate for inclusion in an opinion, are subject to significant legal uncertainty. If the uncertainty extends only to one of the opinions expressed, the question is frequently resolved by a "qualification" to that opinion. The "qualification" may be a statement that the particular opinion does not cover the effect of a certain law or laws or may identify the uncertainty. Such qualifications are usually acceptable to the lawyer for the other party if they relate to demonstrable legal uncertainties.

In accordance with the "Golden Rule" described in Part IV, Section A of this Report, opinion practice has evolved to a common understanding that lawyers should not ask for legal opinions that they would not be prepared to render under substantially similar circumstances. Similarly, an opinion giver should not be asked to render an unqualified opinion on an issue as to which there is significant uncertainty. If there is disagreement regarding the existence or degree of the legal uncertainty, a compromise is sometimes reached in the form of a "reasoned" opinion.[74] In that situation, the opinion giver does not simply express a legal conclusion but also presents a discussion of relevant statutory and judicial authorities, often (but not always)

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72 *See Negative Assurance Report*, 59 BUS. LAW. at 1517.

73 For an illustration of the hazards in providing negative assurance (in this instance, to purchasers of asset-backed securities in a private placement of those securities), *see* Magistrate Judge Joyner's report and recommendation, recommending denial of a prominent opinion giver's motion to dismiss claims under, *inter alia*, Rule 10b-5, common law fraud, and deceit (but granting the opinion giver's motion to dismiss plaintiffs' malpractice claims) in *Pioneer Ins. Co. v. Chase Securities*, 2002 U.S. DIST. LEXIS 7562 (N.D. Okla. 2002). The District Court adopted and affirmed Magistrate Judge Joyner's report and recommendation "in its result." For further background on this litigation, *see In re CFS-Related Securities Fraud Litigation*, 256 F. Supp. 2d 1227 (N.D. Okla. 2003).

74 *See* FIELD TREATISE, § 2.4. "Reasoned opinions" are also sometimes referred to as "explained opinions." *See also Accord*, Certain Guidelines § 11-C; *TriBar Report* § 1.2(a).

indicating that the matter is uncertain or "not free from doubt," and stating a prediction of the likely judicial resolution of the matter if the issue were appropriately presented to a court of competent jurisdiction.[75] By their nature, these opinions can require substantially more time and effort in their preparation than would ordinarily be the case. As a result, issues of cost effectiveness are particularly highlighted in connection with reasoned opinions.[76]

There are several customary formats for reasoned opinions. Historically, "would hold" opinions (expressing a view as to what a court "would hold") were generally regarded as expressing the strongest degree of conviction, and "should hold" opinions were regarded as expressing a somewhat lesser degree of conviction and as more appropriate for areas involving a relatively high degree of legal uncertainty or involving significant policy issues. Recent reports take the position, however, that there is no difference in meaning between a "would hold" and a "should hold" opinion.[77] Some reasoned opinions may use a "more likely than not" standard, which may be appropriate where the relevant authorities are divided, unclear or not directly on point.

Where an issue of legal uncertainty exists, the opinion giver should discuss the matter with its client before agreeing to issue the requested opinion because the opinion may influence the form or even the viability of the transaction as proposed. Matters of this nature are often more appropriately resolved when the party requesting the opinion obtains the views and advice of its own lawyer, rather than obtaining a "reasoned" opinion from the other party's lawyer.[78]

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75 Applicable judicial authorities suggest that a lawyer will not be held liable for errors in the application or interpretation of legal principles that are debatable or uncertain and "will not be held responsible for failing to anticipate the manner in which the uncertainty will be resolved." Metzger v. Silverman, 62 Cal.App.3d Supp. 30, 39, 133 Cal. Rptr. 335, 361 (1976). Nevertheless, if the lawyer's investigation and research leads to the conclusion that the law is unclear, the lawyer generally informs the client and clearly notes the uncertainty in the opinion. Such care is advisable because uncertainty in an area of the law does not necessarily relieve a lawyer of his or her duty to analyze competently the authority in the area that does exist. *See* Aloy v. Mash, 38 Cal. 3d 413, 212 Cal. Rptr. 162 (1985).

The very fact of the discussion of relevant statutory and judicial authorities makes the point that the opinion giver's legal conclusion is uncertain or not free from doubt, without an express statement to that effect. *See ABA Guidelines* § 3.5.

76 *See* Part IV, Section B.1 of this Report. *See also* Appendix 4 ("Report of the Threshold Subcommittee") to the Remedies Report.

77 *See ABA Guidelines* § 3.5. As a practical matter, it can sometimes be difficult to distinguish between being of the opinion that a particular result "would" or "should" occur. In either case, the operative feature of the statement is that it is an expression of a professional opinion, not a statement of fact. For discussion of the gradations of legal opinions in tax practice, see Jasper Cummings' article, cited in note 21.

78 In addition, the advice given to the party requesting the opinion by its own counsel should be protected by the attorney-client privilege.

5. Other Problem Areas: Fraudulent or Misleading Opinions and the Limits of Professional Competence

A lawyer should not render an opinion that the lawyer knows would be misleading.[79] In addition, a lawyer should not render an opinion based on factual assumptions if the lawyer knows that the assumptions are false or that reliance on those facts is unreasonable.[80]

In addition, a lawyer should not be asked to render opinions on matters that are outside his or her area of professional competence.[81] Where an opinion is appropriate but beyond the competence of the opinion giver, then the opinion giver should associate competent counsel to render the opinion. In no event should a lawyer be asked for opinions that are beyond the professional competence of lawyers generally, such as financial statement analysis or valuation.[82]

C. The Time to Negotiate the Opinion Letter

Legal opinions in business transactions are typically delivered in satisfaction of a closing condition of the underlying Agreement between the parties to the transaction; for example, a loan agreement, an acquisition agreement, or an underwriting agreement in a securities transaction. Often, the Agreement sets forth in specific terms the legal conclusions that are to be included in the opinion. Sometimes, however, the Agreement may merely describe generally the matters that are to be covered by the opinion.[83] In either case, the exact text of the opinion (including assumptions and qualifications) should be agreed upon as early as possible in the transaction, preferably before the parties are committed to proceed with the transaction.

Serious differences often arise among lawyers for the various parties concerning the form and substance of the matters to be covered by an opinion. If resolution of these matters is postponed until a short time before the closing, the result will often be either a form of opinion unfairly based on the superior bargaining power of one party or possible misunderstandings between an opinion giver that is reluctant to render a particular opinion and its client. Resolution of these differences early in the transaction will allow the opinion giver to focus on the matters that involve factual and legal verification and thereby facilitate a timely closing.

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79 *See* Roberts v. Ball, Hunt, Hart, Brown & Baerwitz, 57 Cal. App. 3d 104, 128 Cal. Rptr. 901 (1976). *See also* note 45; Appendix 10 ("Exceptions Subcommittee Report") to the Remedies Report at "Final Admonition"; *TrBar Report* § 1.4(d); *ABA Guidelines* § 1.5; and Part III, Section B of this Report.

80 *See TriBar Report* § 2.1.4; RESTATEMENT § 95 note (c). *See also* Appendix 10 ("Exceptions Committee Report") to the Remedies Report at "Further Notes" ("Use of Assumptions to Close Gaps").

81 *See* Part IV, Section D.5 of this Report.

82 *See ABA Guidelines* § 1.4.

83 Counsel for the opinion recipient will sometimes include a provision in the Agreement stating that the opinion will cover "such other matters" as counsel for the recipient "may reasonably request" or, conversely, that the opinion will be subject to customary or reasonable assumptions, qualifications and limitations. These provisions can create substantial uncertainty and place the opinion giver in a difficult position, for example when the lawyer is reluctant to give an opinion on a new matter raised a short time prior to a closing. Such a provision might also be abused by the recipient if the recipient unreasonably demands an opinion on a particular issue and thereby seeks to avoid the closing.

D. The Form and Elements of the Opinion Letter

There is no form for a legal opinion prescribed by law or rule. Opinion letters, however, have developed a certain uniformity because of their repeated use in similar business transactions and because the phrasing of common opinions is often contained in bar association reports, such as this Report. In general, a legal opinion will cover the following: (1) introductory matters, such as the date, the identity of the opinion recipient, the role of the opinion giver giving the opinion, and the purpose for which the opinion is given; (2) a general or specific recitation of the documents and other factual and legal matters reviewed by the opinion giver, including in some instances a statement of reliance on various factual assumptions;[84] (3) the legal conclusions expressed in the opinion, and any qualifications to the legal conclusions; (4) matters peculiar to the particular opinion, such as matters relative to opinions of local counsel in other jurisdictions and specific limitations on the use of the opinion; and (5) the signature of the opinion giver.

1. Introductory Matters

Date. The opinion letter will commonly be delivered at the closing of the business transaction and bear that date. The opinion speaks as of that date and need not state separately the effective date of the opinion.[85] If for some reason a conclusion expressed in the opinion is reached as of a date prior to the delivery of the opinion, the opinion giver may so specify in the opinion letter.[86]

In some circumstances, the opinion giver may deliver an opinion letter that bears a later date with instructions that the opinion letter is to be delivered on its effective date (generally, the closing date of the transaction). Whether the opinion letter is physically delivered by the opinion giver or by a third party, the opinion giver is responsible for confirming that the factual and legal matters covered in the opinion letter are accurate as of its date (or an earlier date specified in it). This obligation normally includes such tasks as updating any factual certificates and similar matters.[87]

Addressee. The opinion is normally addressed to a specified party to the transaction in an individual capacity, to a party as representative of a larger group, or to an identified class of

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84 Lawyers often assume, among other things, the legal capacity of individuals, that copies of documents furnished to them conform to the originals, that the signatures on executed documents are genuine, and the proper corporate power and authorization by the other parties to a contract. The TriBar Report takes the position that these assumptions need not be stated. *TriBar Report* § 2.3(a). The Committee supports that conclusion. As with other unstated assumptions, the opinion giver may not rely on an assumption if reliance is unreasonable under the circumstances in which the opinion is rendered. *See id* § 2.1.4.

85 *See* RESTATEMENT § 95, Reporter's Note. Although the Committee believes that it is not necessary, some lawyers specifically disclaim any obligation to update an opinion after it is rendered, particularly where the transaction involved may be ongoing, such as a revolving credit agreement. A typical form of disclaimer reads as follows: "Our opinion is rendered as of the date hereof and we assume no obligation to advise you of changes that may hereafter be brought to our attention."

86 See, for example, the discussion of "Reliance on Certificates of Public Officials" in Part IV, Section D.3 of this Report.

87 *See* Part IV, Section D.3 of this Report.

persons. Examples of the latter two situations are "XYZ Underwriting Firm, as representative of the several underwriters" and "to the purchasers of the 5% promissory notes of ABC Corp." In all cases, it is customary practice for the opinion recipient to be clearly identified in the opinion letter.[88]

Generally, the only person or persons entitled to rely on an opinion are the person or persons to whom the opinion letter is specifically addressed. No additional limitation need be expressed in the opinion letter. As a matter of prudence, however, many lawyers include a sentence at the conclusion of the opinion letter to the following effect:

> The opinions set forth herein are rendered solely for your use in connection with the above transaction and may not be relied upon, delivered to or quoted by any other person or for any other purpose without our prior written consent.

In some limited instances, an opinion letter is intended to be relied upon by persons other than the stated addressee(s). Examples include an opinion letter addressed to an underwriter concerning the validity of a proposed stock issuance that is also to be relied on by the issuer's transfer agent, and an opinion letter of local counsel on which the principal opinion giver will rely to render its opinion.[89] In those cases, the opinion letter normally states specifically who, in addition to the addressee, is entitled to rely upon the opinion.[90]

The foregoing discussion does not address situations in which the opinion giver knows or has reason to believe that the client will supply to third parties an opinion letter that is addressed solely to the client. In those cases, the opinion giver's responsibility may extend to those additional persons; and limitations expressed in the opinion letter may not have legal effect.[91] Because the exposure of the opinion giver to potential liability may be greater in these situations, the opinion giver should consider carefully whether the opinion letter should include a more explicit qualification or whether it should be rendered at all.

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88 An opinion giver may also be called upon to deliver a separate opinion letter to its client as part of the closing conditions to a particular business transaction. In that case, the opinion letter would be addressed to the client.

89 The TriBar Report notes the evolving practice whereby opinion recipients are increasingly willing to accept separate opinions of counsel rather than one "bundled" opinion from the primary opinion giver. *See TriBar Report* § 5.2.

90 In loan transactions, it is common for the lender to sell participations in the loan to other lenders. In such instances, the lender will normally request the borrower's counsel to permit such participants to rely upon the opinion. In normal circumstances, most lawyers permit such reliance. *See* Real Property Law Section, State Bar of California & Real Property Section, L.A. County Bar Ass'n, *Legal Opinions in California Real Estate Transactions* (1987), 42 BUS. LAW. 1139, 1156 (1987). Those participants are permitted to rely on the closing opinion to the same extent as – but to no greater extent than – the addressee. *ABA Guidelines* § 1.7.

91 *See* Part III, Section B of this Report.

2. Description of the Transaction, the Lawyer's Role, Reasons for the Opinion and Definitions

The Transaction and the Lawyer's Role. An opinion letter normally describes the capacity in which the opinion giver is rendering the opinion and the nature of the transaction. This typically can be accomplished in a single sentence, such as:

> We have acted as counsel to ABC Corp., a California corporation (the "Company"), in connection with the merger of the Company with and into XYZ Corp., a California corporation ("XYZ"), pursuant to the Agreement and Plan of Reorganization dated as of _____ __, 20__, by and between the Company and XYZ (the "Agreement").

The opinion giver may wish to describe further its role as "general" or "special" counsel. Such descriptive terms, however, have no generally-recognized meaning. Therefore, they should not be viewed as a substitute for appropriate substantive qualifications or limitations on the scope of the opinion giver's role in the transaction. Most opinion givers believe that the term "general counsel" should not normally be used, unless the opinion is being given by inside general counsel for the Company. For other lawyers, the use of the term "general counsel" may indicate a continuing knowledge of all corporate affairs that is beyond the scope of the opinion letter.

The term "special counsel" does not limit the opinion giver's responsibility for the opinions rendered by it.[92] Accordingly, if the opinion giver is not involved generally in representing the client and has been asked for an opinion on a limited matter, it may be advisable for it to describe the scope of its limited involvement with the client or the transaction, rather than rely solely upon the implication of limited participation by the reference to "special" counsel.[93]

The opinion giver sometimes will state that it has participated in the preparation of the Agreement in question and, usually by implication, in the exhibits that are part of the Agreement. By reciting this history, the opinion giver might raise the inference that it is assuming some responsibility for factual matters set forth in the Agreement, including the exhibits. The assumption of this responsibility is commonly understood to be well beyond the opinion giver's role.[94] The Committee therefore recommends that a statement of participation in the preparation of the Agreement and its exhibits be avoided.

Reasons for the Opinion. The opinion giver will usually specify why the opinion is being rendered. This typically is accomplished by a simple reference as follows:

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92 *See also* Part IV, Section D.5 of this Report regarding reliance on a "special counsel" opinion by the primary opinion giver.

93 The term "special counsel" is also frequently used to refer to a lawyer who has been asked to render an opinion as a specialist in a particular field of law. *See* Part IV, Section D.5 of this Report.

94 *See* Part IV, Section B of this Report.

This opinion is rendered pursuant to Section ___ of the Agreement.

Definitions. For purposes of brevity and clarity, it is advisable to define the principal terms used in the opinion. Terms that are defined in the underlying Agreement are most often given the same definitions in the opinion, either by defining each term in the opinion or by a reference to the Agreement, such as:

The terms used in this opinion letter that are defined in the Agreement have the same definitions when used herein, unless otherwise defined herein.

Whenever a term utilized in an opinion letter is derived from statutory law, the opinion customarily uses that term or provides an express definition. For instance, the California General Corporation Law[95] (as amended, the "GCL") refers to "articles of incorporation," "shareholders" and "shares," rather than the corresponding terms of "certificate of incorporation," "stockholders" and "stock" as used in statutes of some other jurisdictions, such as Delaware.

3. Diligence, Factual and Legal

The obligation of an opinion giver to exercise customary diligence in determining the factual and legal bases for an opinion is implicit in every opinion letter. In the discussion that follows in this subsection and in Part V of this Report, the Committee addresses the factual and legal diligence customarily conducted by California opinion givers in the preparation of an opinion letter.

Description of Factual Examination. The opinion giver must be satisfied that it has reviewed or assumed (expressly or implicitly) sufficient facts to support each of the legal conclusions expressed in the opinion letter. In most instances, the opinions in an opinion letter can be supported by an examination of documents, either in their original form or copies identified to the satisfaction of the opinion preparers, or of certificates of public officials or officers of the Company relating to factual matters.[96]

Some opinion givers preface their opinion letters with a reference to a detailed list of the documents and certificates examined, together with either a statement that they have examined such other documents and have made such further legal and factual investigation as they consider necessary for purposes of rendering the opinion[97] or, alternatively, a specific disclaimer to the

95 CAL. CORP. CODE §§ 100-2319.

96 *See* "Documentary Examination Assumptions" in this Section D.3 below. *See also* Part V, Section C.6 of this Report as well as Part V, Section E.1 of this Report regarding standards of factual inquiry specifically applicable to opinions with respect to certain securities law matters.

97 A common form of statement to this effect is as follows:

(footnote continued on next page)

effect that they have not made any other examination or factual investigation.[98] Other opinion givers prefer to deliver opinion letters that merely set forth language to the following effect:

> We have been furnished with and have examined originals or copies, certified or otherwise identified to our satisfaction, of all such records of the Company, agreements and other instruments, certificates of officers and representatives of the Company, certificates of public officials and other documents as we have considered necessary to provide a basis for the opinions hereinafter expressed. We have not independently established the facts stated therein.

At times, the decision whether to set forth a list of documents and certificates reviewed by the opinion giver is dictated by the opinion recipient. Certain lending institutions and securities underwriters desire the "long-form" opinion letter containing such a list to provide the additional comfort that the opinion giver has reviewed the listed documents for purposes of its opinion. In most instances, however, the decision is based on the preference of the opinion giver, and it is sometimes influenced by whether the opinion giver has represented the Company in general matters for some time or only for purposes of the specific transaction. If the opinion giver intends to limit the scope of the opinion to the documents and certificates listed, it should include an express statement to that effect in the opinion. If no specific limitation is included, a

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(footnote continued from previous page)

> We have made such further legal and factual examination and investigation as we deem necessary for purposes of rendering the following opinions.

98 These limitations on the scope of a lawyer's examination of factual matters are often expressly stated when the lawyer has played a limited role in the transaction. Such circumstances are commonly set forth clearly in a sentence such as the following:

> In rendering the opinions hereinafter expressed, we have relied solely upon our examination of the foregoing documents and certificates, and we have made no independent verification of the factual matters set forth in such documents or certificates.

If the introductory paragraphs of the opinion do not list the documents and certificates examined, this limitation can be expressed by reference to facts and documents disclosed in an officers' certificate. For example:

> In giving the opinion expressed in paragraph ___ above, we have relied solely upon a certificate of _____ listing [all] [certain] evidences of indebtedness, agreements and instruments to which the [Company] is a party and all judgments, orders and decrees of any court or arbitrator binding upon the [Company].

See "Officers' Certificates" in the text following note 105 for a general discussion of officers' certificates.

list of documents is not generally understood to constitute a limitation on the general responsibility of the opinion giver to follow customary diligence in rendering the opinion.[99]

Reliance on Certificates of Public Officials. Usually opinions include legal conclusions concerning the corporate nature and existence of the Company and its ability to transact business in its state of incorporation. They also often include legal conclusions concerning the good standing and ability of the Company to transact business in other jurisdictions. These opinions customarily are based on certificates of public officials in the various jurisdictions involved. For California corporations, the Secretary of State and the California Franchise Tax Board (the "Franchise Tax Board" or "FTB") are the principal sources of such information.[100] The principal certificates are as follows:[101]

1. *Certified Copy of the Articles of Incorporation, together with Amendments*. This is a copy of the Company's articles of incorporation, and all amendments, certified by the Secretary of State (the "articles").[102] This certification represents conclusive evidence of the formation of the corporation and prima facie evidence of its existence for all purposes other than in an action by the California Attorney General.[103]

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99 *See TriBar Report* § 1.5 (A material departure from any aspect of customary practice (including customary diligence or usage) should be expressly described in the opinion letter. For example, a mere listing in an opinion letter of documents examined is not sufficient to give notice to the recipient that the opinion giver reviewed only the listed documents (rather than the documents customary practice would cover)); *Id.* § 1.4(c) (Opinion letters often state (immediately before the opinion paragraphs) that the opinions being expressed are based on a review of certain identified documents "and such other investigation as we [the opinion giver] have deemed appropriate." The term "investigation" is generally understood to relate to both law and fact. Thus, the "such other investigation" statement merely emphasizes that the opinion letter is given in accordance with customary practice and its omission is not sufficient, by itself, to indicate that customary practice is not being followed).

The TriBar Report defines "unreliable information" as follows:

> The opinion preparers may rely on information provided by an appropriate source … unless reliance is unreasonable under the circumstances in which the opinion is rendered or the information is known to the opinion preparers to be false …

TriBar Report § 2.1.4 (footnotes omitted). For an extensive discussion of establishing the factual basis for an opinion, see chapter four of GLAZER & FITZGIBBON.

For a discussion of misleading opinions, s*ee TriBar Report* § 1.4(d); *ABA Guidelines* § 1.5. *See also* Part III, Section B, and Part IV, Section B.5 of this Report.

100 The good standing and authority of foreign corporations to transact intrastate business in California may likewise be confirmed through certificates from the Secretary of State and the Franchise Tax Board.

101 As processing delays are sometimes encountered, lawyers wishing to obtain these certificates should contact the office of the Secretary of State or the FTB, as the case may be, sufficiently in advance to ensure that the requested certificates can be obtained prior to the closing of the transaction. They can often be obtained more quickly through various independent document services.

102 Under California law, the term "articles" includes the articles of incorporation, amendments thereto, amended articles, restated articles, certificate of incorporation and certificates of determination. CAL. CORP. CODE § 154. As used in this Report, the term "articles" includes reference to the applicable charter in cases where the Company is incorporated under the laws of a jurisdiction other than California.

103 *See* CAL. CORP. CODE § 209.

2. *"Bring-Down" Certificate regarding Incorporation and Amendment of Articles*. This is a certificate of the Secretary of State setting forth the date the Company was incorporated and listing all amendments to the articles filed on or prior to the date of the certificate. This certificate often is obtained prior to the closing for purposes of confirming that there have been no corporate changes since the date that the copy of the articles was certified.

3. *Certificate of Status*. This is a Certificate of Status of a Domestic Corporation furnished by the Secretary of State, which certifies the Company's organization, good legal standing, authorization to exercise corporate powers and ability to transact business in California.[104] This certificate also confirms that no certificate of dissolution of the corporation has been filed with the Secretary of State.

4. *FTB Good Standing Letter*. This is a letter from the Franchise Tax Board stating that the Company is in good standing with respect to its state franchise tax filings and has no known unpaid tax liability. This letter confirms that no Franchise Tax Board proceedings are pending to suspend the corporate powers of the Company.[105]

The opinion giver may also verify by telephone with the office of the Secretary of State that the Company is in good standing on the date the opinion is being delivered. The Franchise Tax Board will also confirm by telephone good standing with respect to state franchise tax filings and payments.

Public officials in other states will furnish similar certificates relating to good standing and tax delinquencies, and these certificates can normally be updated (or "brought-down") by telephone or electronically to the date preceding the delivery of the opinion. Many states have implemented websites on which such information can be accessed at any time. The information on any particular website can only be relied upon as current to the extent specified by the state agency responsible for that website. Certificates and confirmations from public officials in foreign jurisdictions are customarily secured through service bureaus and arrangements made for delivery of such certificates and confirmations well in advance of the closing.

Certificates of public officials also support other parts of a legal opinion. For example, licensing bodies, such as the California Departments of Insurance, Corporations and Financial Institutions, will normally provide certificates relating to the existence of particular licenses.

Because certificates of public officials will normally bear a date before the delivery of the opinion, the opinion giver must decide what additional verification, if any, is necessary for purposes of the opinion. Although in some instances telephonic updates can be obtained prior to the closing, this is not always the case. Additional verification may or may not be necessary

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104 A corporation's failure for 24 months or more to file the Annual Statement required under Section 1502 of the California Corporations Code may lead to suspension by the Secretary of State of its ability to transact business. *See* CAL. CORP. CODE § 2205. The fact and date of the latest filing can be confirmed with the Secretary of State by telephone to assure that the corporation is not susceptible to suspension prior to the anticipated opinion date.

105 In routine transactions, many lawyers do not request a Franchise Tax Board good standing letter unless they have a particular concern regarding potential delinquency of franchise taxes or tax filings.

depending upon the facts and circumstances of the case. In general, customary practice does not require that every certificate be updated. Opinion recipients routinely accept opinions that in part are based on certificates of a reasonably recent date. Sometimes, the opinion giver will specify in its opinion that it is relying upon certificates of public officials of an earlier date without "bring-down" certificates.

Officers' Certificates. Opinion preparers typically obtain two somewhat analogous types of officers' certificates: (1) certificates verifying the authenticity of referenced documents; and (2) certificates relating to factual matters not readily verifiable by the opinion preparers or only verifiable at considerable cost. A common example of the first type of certificate is a certificate of the secretary of the Company certifying that, attached to the certificate, is a true copy of the articles, bylaws and corporate minutes or resolutions pertaining to the transaction. A typical form of such certificate follows:

Certificate of Secretary of XYZ Corporation

I, Pat Doe, certify that I am the duly elected and acting Secretary of XYZ Corp., a California corporation (the "Company"), and that attached hereto as Exhibit A is a true and correct copy of [the articles of the Company as certified by the California Secretary of State on _____ __, 20__] [the bylaws of the Company] [resolutions of the Board of Directors of the Company duly adopted at a special meeting of the Board held on _____ __, 20__.] and that the same have not been [amended][rescinded or changed] and are now in full force and effect.

Under Section 314 of the California Corporations Code (the "Corporations Code"), the certificate itself is prima facie evidence of the adoption of the bylaws and resolutions. This officers' certificate is often expanded, or separate certificates obtained, to certify such additional documents and matters as the articles, as amended through the date of closing, or information concerning the Company's outstanding shares.

The signatures and corporate capacities of the individuals executing an officers' certificate may also be supported by an incumbency certificate containing the signatures of various corporate officers who have signed documents pertinent to the transaction. A typical form of such a certificate follows:

Incumbency Certificate

I, Pat Doe, certify that I am the duly elected and acting Secretary of XYZ Corp., a California corporation (the "Company"), and that at all times from _____ __, 20__ to and including [the closing date] the following were the duly elected and acting officers of the Company and their true signatures appear opposite their names:

Title of Officer	Name of Officer	Signature
_____	_____	_____

_____
Pat Doe, Secretary

Some lawyers are concerned that a certificate in this form contemplates that the opinion giver will either compare signatures on the certificate for any obvious differences with those on the relevant documents or witness the signing by those officers. To eliminate this concern, some opinion givers use an alternative form of incumbency certificate such as the following:

Incumbency Certificate

I, Pat Doe, certify that I am the duly elected and acting Secretary of XYZ Corp., a California corporation (the "Company"), and that at all times from _____ __, 20__ to and including [the closing date] the following were the duly elected and acting officers of the Company holding the respective offices indicated below at the respective times of the signing and delivery of the [list of relevant documents], and the signature of each such person appearing on each such document is his or her genuine signature.

Title of Officer	Name of Officer
_____	_____
_____	_____
_____	_____

_____
Pat Doe, Secretary

Whichever approach is used, the certificate customarily ends with an officer other than the secretary attesting to the secretary's signature.

Officers' certificates of this nature are sometimes delivered to the other party at the closing to provide assurance, in addition to the legal opinion, that corporate action has been properly taken. These certificates will often be obtained even though the opinion giver will usually have reviewed the bylaws of the Company, relevant minutes contained in the minute book and the stock records.

The second type of officers' certificate relates to factual matters not readily verifiable or only verifiable at considerable cost by the opinion giver when preparing the opinion. These certificates are used as factual support for legal conclusions expressed in the opinion. The need for them arises, for example, when an opinion giver renders an opinion that the transaction will not cause a breach of the terms of any loan agreement to which the client is a party. The opinion giver is competent to review the loan agreements but may need an officers' certificate to identify the loan agreements to which the client is a party since, typically, the opinion giver is not in a position to know what agreements to review. If the Agreement includes a list of such agreements, the opinion giver may alternatively rely on that list. The opinion giver will usually require an additional certificate of an appropriate officer of the Company that financial covenants

and other financial provisions in the agreements covered will not be breached by consummation of the transaction in question.[106]

Factual certificates are normally prepared by the opinion giver with input from appropriate officers or employees of the Company as to the factual matters they cover.[107] The certificate should not simply restate legal conclusions (e.g., that the Company is duly incorporated, validly existing, and in good standing), but instead should recite factual matters reasonably within the competence of the officer signing the certificate. If the certificate merely sets forth legal conclusions, the certificate may be of little assistance in the event that the legal opinion is subsequently questioned.[108]

Practice differs with respect to the delivery of factual "back-up" certificates at the closing to the opinion recipient. Some opinion givers prefer to attach the certificates to their opinion. Unless the opinion giver expressly limits the scope of its investigation to documents or matters identified by the certificates, the opinion giver does not typically deliver supporting officers' certificates to the other party or its counsel, and the opinion recipient also does not typically request an opportunity to review such certificates. The opinion giver must use its own judgment in determining under what circumstances (and to what extent) reliance on factual matters contained in the certificates can be justified. The opinion giver should also exercise its own judgment in determining those circumstances and matters which reasonably should be supported by an officers' certificate. When officers' certificates are utilized to define and limit the scope of investigation underlying the opinion, however, the lawyer representing the opinion recipient typically reviews the supporting officers' certificates referenced by the opinion giver, particularly when the opinion giver disclaims any investigation beyond such certificates.[109]

Documentary Examination Assumptions. Opinion givers customarily assume that the signatures on all documents examined are genuine, that copies of documents examined conform to the originals, and that such documents were duly authorized and properly executed by other parties. Opinion givers often state these assumptions expressly, although the Committee believes

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106 Alternatively, the opinion giver may include in the opinion letter an assumption that the financial covenants will not be violated by the transaction or may expressly disclaim an opinion with respect to those provisions. *See* note 159 and the accompanying text.

107 The factual certificate should be reviewed and signed by a person with the particular knowledge described in the certificate. *See TriBar Report* § 2.2.1(c).

108 Opinion preparers often may determine that certain facts need to be established to render a legal opinion. Typically, they discuss the facts with an officer or officers and draft an appropriate certificate for officers to sign setting forth the facts. The opinion preparers should be mindful of the dual functions they fill in that context (preparing the certificate and then relying on it).

109 See "Description of Factual Examination" above as to the use of officers' certificates in the context of limitation on the scope of an opinion.

that, by customary usage, they are implicit and need not be expressly stated.[110] If stated, a common formulation of the assumption is as follows:

> In rendering this opinion, we have assumed: the authenticity of all documents submitted to us as originals; the conformity to originals of all documents submitted to us as copies; and the accuracy, completeness and authenticity of all certificates of public officers.[111]

Law Covered. An opinion letter covers only law that a lawyer exercising customary professional diligence would reasonably be expected to recognize as being applicable to the opinion giver's client, the transaction or the Agreement to which the opinion relates.[112] By customary practice, an opinion is understood not to cover such laws as local or municipal law or certain specialized areas of the law (*e.g.*, antitrust, environmental, land use, securities, tax, pension, employee benefit, insolvency, fraudulent transfer, margin requirements and investment company issues) unless the opinion expressly covers them.[113]

4. Expression of the Opinion

Introduction. The substantive portion of the opinion normally begins with an introductory statement referring to matters upon which the opinion giver has relied. This introductory statement is generally phrased in a manner that does not limit the opinion giver's investigation to the matters specifically described, but rather indicates that the opinion giver has made such further investigation as it considers appropriate under the circumstances. An example of such an introductory statement reads as follows:

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110 *See* note 84.

111 The TriBar Report takes the position that these assumptions are of "general application" and need not be stated in opinion letters. *TriBar Report* § 2.3(a). See note 84 for the Committee's position.

112 *See ABA Principles* § II.B; *TriBar Report* § 6.6; Appendix 8 ("Application of Customary Practice to the Remedies Opinion") to the Remedies Report.

113 *See ABA Principles* §§ II. C and II.D; Appendix 10 ("Report of the Exceptions Subcommittee") to the Remedies Report, at "Further Note." *See also* Part V, Section C.4 of this Report. The "bankruptcy exception" to the remedies opinion is understood to exclude the effect of insolvency and fraudulent transfer laws from the remedies opinion. *See TriBar Report* § 3.3.2 ("[t]he bankruptcy exception is more aptly an 'insolvency law exception' in that it covers not only the federal Bankruptcy Code but also any other similar insolvency laws (state or federal) of general application. . . . Fraudulent conveyance (or transfer) laws are included in the laws covered by the exception."); *ABA Guidelines* § 4.6. Accordingly, a separate specification of laws not covered by the opinion need not specify insolvency and fraudulent transfer laws if the opinion includes the remedies opinion with its bankruptcy exception. In addition, by customary practice, the "no violation of law" opinion is understood not to cover insolvency and fraudulent transfer laws. *See* Part V, Section C.4 of this Report; *TriBar Report* § 6.6.

> Based on the foregoing and upon such further investigation as we have considered necessary,[114] it is our opinion that:

The expression of the actual opinion (i.e., "it is our opinion that") varies according to the practice of the particular opinion giver. Other customary variants include the following: "we are of the opinion that;" "we express the following opinions;" or "our opinion is as follows." Sometimes opinion givers will use "we advise you that;" "we believe that;" "we are of the view that;" or "we may state that." These latter formulations may imply that something other than a normal opinion is being given and typically are not used in closing opinions, except in securities law "negative assurance" statements.[115]

The Operative Language. Closing opinions are becoming increasingly customary and uniform. Part V of this Report provides examples of typical kinds of opinions, with a discussion of the meaning of terms customarily used in such opinions and the uncertainties and special problems existing under California law. Part V also includes suggested procedures to be followed in rendering opinions.

Qualifications. In practice, opinions are frequently subject to qualifications that narrow their apparent scope.[116] Some opinions may be qualified by assumptions or exceptions. Opinions also may be qualified as to scope, particularly when the opinion covers a specialized area of the law. Qualifications take various forms, depending upon the opinion giver's preference and the length of the qualification. If the qualification is short and applies only to one portion of the opinion letter, it often will be included in the operative language of the specific opinion by the reference "subject to _____" or "except _____". If the qualification pertains to more than one portion of the opinion letter or is lengthy, it will usually appear separately from the operative opinion clauses. Typical clauses introducing such qualifications include the following: "our opinion in paragraph ___ is subject to;" or "we express no opinion on the effect of;" or "in rendering our opinion in paragraph ___ we have assumed that [describe assumptions]."

References to the concurrence or consent of the opinion recipient, although not objectionable and often expressly stated in opinion letters, are not necessary to convey the opinion recipient's acquiescence to the qualifications stated in the opinion letter. Instead, to the

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114 *See* "Description of Factual Examination" in this Section D.3 above, including notes 97 and 98.

115 *See* Fuld at 922. *See also* Part IV, Section B.3 of this Report (particularly including notes 68-71); *Negative Assurance Report*.

116 The TriBar Report states that each qualification of an opinion is an "exception," which may either take the form of a "limitation" or an "exclusion." Exceptions narrow an opinion's scope. *See TriBar Report* § 1.2(a). This is distinguished from "assumptions," which act as "fact substitutes" to facilitate the rendering of an opinion. *Id*. § 2.3. Exceptions, limitations, exclusions and assumptions all fall under the general rubric of qualifications. Issues as to the qualifications or assumptions in an opinion often relate to the "remedies" or "enforceability" opinion. Readers should refer to the Remedies Report, and particularly its Appendix 10 ("Report of the Exceptions Subcommittee") for a discussion of the qualifications and assumptions appropriate for these opinions.

extent that significant qualifications are set forth in an opinion letter, the opinion recipient (or other third party accepting the opinion letter) will be considered to have accepted them (as well as those customarily understood to be implicit).

Qualifications cover a variety of matters. Qualifications may relate to facts that are particularly within the knowledge of the opinion recipient or to present or future events. An example of the former from commercial law is an opinion relating to the receipt of shares of a corporation free of adverse claims. Under the California Uniform Commercial Code, a purchaser who acquires securities for value in good faith without notice of adverse claims acquires the securities free of any adverse claim.[117] If this opinion is given, the opinion giver typically includes an assumption that "the purchaser is acquiring the shares in good faith without notice of any adverse claim." Because these facts are peculiarly within the knowledge of the purchaser, this qualification is customarily viewed as appropriate.[118]

A typical transaction involving the transfer of a security also provides an illustration of an appropriate qualification with respect to the occurrence of a future event. An opinion giver will sometimes state that an opinion regarding the absence of adverse claims will become operative "upon delivery by the seller of the certificates with all necessary endorsements for the shares and payment therefor." A qualification of this nature is typically acceptable to the opinion recipient.

Another type of qualification may be appropriate when the opinion giver is unwilling to take responsibility for certain laws. For instance, an opinion giver may expressly exclude compliance with laws affecting certain regulated industries — such as the utility, telecommunications or banking industries — from its opinion. If the opinion recipient wants an opinion that the opinion giver cannot give, special counsel often will be engaged to render it.[119] If, for example, the Company is a public utility and the opinion giver is unwilling to give an opinion on public utility law, special counsel normally will be retained for this purpose.

Limitations on the Basis of Knowledge. Factual confirmations are often limited by reference to the opinion giver's knowledge. These limitations take many different forms, although typical phrases usually include the following: "to our knowledge"; "to our current actual knowledge"; "to the best of our knowledge"; "we do not know of"; "we are not aware of"; or "nothing came to our attention that." These qualifications all indicate some lack of factual investigation by the opinion preparer. What they mean, however, is not entirely clear.[120] The

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117 CAL. COM. CODE § 8303. *See also* Part VII, Section C of this Report. If not bearer shares, the securities also need to be endorsed. *See* CAL. COM. CODE §§ 8106, 8303.

118 *See* Business Law Section & Real Property Section, State Bar of California, *Report Regarding Legal Opinions in Personal Property Secured Transactions*, as reprinted in 44 BUS. LAW. 791 (1989), at 832-34. The purchaser may seek to bolster its position regarding good faith and lack of notice by requesting a representation from the seller that it has no notice of any adverse claims with respect to the securities.

119 *See* Part IV, Section D.5 below, " Special Matters."

120 *See ABA Guidelines* §3.4; *ABA Principles* § III.B; *TriBar Report* §2.6.1. *See also* FIELD TREATISE § 2:14.2.

Committee, therefore, recommends that opinion givers state the meaning of whatever phrase is used in the opinion, such as by the following:[121]

> Whenever a statement herein is qualified by "known to us," "to our current actual knowledge," "our knowledge" or similar phrase, it is intended to indicate that, during the course of our representation of the Company in this transaction, no information that gives us current actual knowledge of the inaccuracy of such statement has come to [our attention] [or the attention of those lawyers currently in this firm who have rendered legal services in connection with the representation described in the introductory paragraph of this opinion letter]. However, [except as otherwise expressly indicated,] we have not undertaken any independent investigation to determine the accuracy of such statement, and no inference as to our knowledge of any matters bearing on the accuracy of any such statement should be drawn from the fact of our representation of the Company.

Knowledge limitations are different for law firms than for individual opinion givers or inside lawyers.[122] In firms with many lawyers, the phrase "our current actual knowledge" or "our knowledge" could be interpreted to mean the knowledge of the entire firm. It may be impractical to expect that the opinion preparers are aware of all other client matters within the knowledge of all other lawyers in the firm. An opinion giver may therefore attempt to expressly limit knowledge to that of the group of lawyers within the firm working on the current transaction, as indicated in the qualification language provided above.

Some commentators note that lawyers are moving away from the use of knowledge qualifiers by limiting opinions that rely upon factual matters, such as the no breach or default opinion, to an identified set of facts, such as a list of contracts identified in the opinion letter.[123]

5. Special Matters

Foreign Law and Reliance on Local Counsel. The principal opinion giver for a party in a business transaction typically renders an opinion covering the laws of the state of the Bar membership of the opinion preparers and applicable federal laws and sets forth this limitation in

121 *See also* the discussion of knowledge qualifiers in note 259.

122 *See* Section II.F of the ABA Inside Counsel Report. *See also Accord* §§ 6-A, 6-B and commentary. *Cf.* Am. Bar Ass'n, *Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information*, 31 BUS. LAW. 1709 (1976).

123 *See ABA Guidelines* § 3.4 n.11; *see also* Part IV, Section B.1 of this Report.

the text of the opinion.[124] The opinion giver may also be requested to furnish an opinion on matters governed by the laws of some other state or country. Unless the limited nature of the review of another jurisdiction's law is described in the opinion, because the opinion giver would likely be held to the same standard as a lawyer licensed or otherwise competent to give advice on the law of the other jurisdiction, the opinion giver will, in most instances, seek the advice and opinion of local counsel.[125]

There are certain uncomplicated questions of foreign law on which California lawyers customarily render opinions. Many California lawyers experienced in corporate matters are familiar with Delaware corporation law (including court decisions interpreting that law) and are competent to render opinions that cover matters relating to the incorporation and good standing of a Delaware corporate client and certain other routine corporate matters.[126] An opinion giver should, however, always be cognizant of the fact that rendering an opinion based upon legal principles applicable in foreign jurisdictions exposes the opinion giver to liability for a negligent interpretation of that law.

The retention of local counsel to furnish an opinion raises different questions with respect to the principal opinion giver's responsibility for the opinions expressed in the local lawyer's opinion.[127] If the principal opinion giver renders an opinion on the same matters as the local lawyer, the opinion giver customarily expresses its reliance on the local counsel's opinion (an example of recommended language is included below) rather than simply restating the local counsel's opinion in the body of its opinion:

> In rendering the opinions expressed in paragraphs __, __ and __, we have relied [solely] on the opinion of _____ insofar as such opinions relate to the laws of _____, and we have made no independent examination of the laws of that jurisdiction.

When expressly stating reliance on the opinion of local counsel, the principal opinion giver's sole responsibility is to exercise reasonable care in the selection of local counsel (if, in

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124 A common form of limitation reads as follows:

> We are opining herein as to the [effect on the subject transaction only of the] laws of California and of federal law, and we express no opinion as to the applicability thereto, or the effect thereon, of the laws of any other jurisdiction.

Where necessary, multi-state law firms are generally able to render opinions on the laws of various states where they have offices, since lawyers in each office may review and approve the opinion insofar as it relates to the laws of their respective states.

125 *See* Part VI, Section A of this Report and Appendix 10 ("Report of the Exceptions Committee") to the Remedies Report, Annex B ¶ 1.

126 *See also* Part VI, Section B.1 of this Report; *TriBar Report* § 5.3.

127 *See* Part VI, Section A.1 of this Report.

fact, the principal opinion giver selects such counsel).[128] The opinion giver is not responsible for independently investigating or otherwise verifying the law of the foreign jurisdiction.[129] The principal opinion giver may assume some responsibility to examine the statutory and case law of the foreign jurisdiction if the principal opinion giver's opinion letter states that the opinion giver "concurs" with the legal opinions provided in the opinion letter of local counsel, that the local counsel's opinion letter is satisfactory in substance, or that the opinion recipient is justified in relying on the local lawyer's opinion.[130] Accordingly, a principal opinion giver's opinion letter customarily does not do so. The preferred and more recent common practice is for the local counsel's opinion letter to be addressed to the recipient of the principal opinion letter (rather than to the principal opinion giver) and for the principal opinion giver not to render an opinion on that subject.

From the principal opinion giver's standpoint, the preferable approach is to separate the opinions set forth in its opinion letter from the opinions set forth in the opinion letter of local counsel.[131] In the early stage of discussions concerning the opinions to be rendered, local counsel generally is agreed upon by both parties (regardless of whether already retained). The principal opinion giver prefers that the Agreement provide for independent delivery to the opinion recipient of the local counsel's opinion letter with respect to specified matters as a condition to the closing. The principal opinion giver may consider an express exclusion of the matters covered in the opinion letter of local counsel from the scope of the opinions set forth in its opinion letter, or express reliance (without independent verification) of the opinions expressed by local counsel.[132] This procedure will normally be acceptable to the lawyer for the opinion

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128 The TriBar Report states that, by expressing reliance on the opinion of local counsel, the principal opinion giver indicates that "such reliance is in its professional judgment reasonable," which presupposes that the principal opinion giver has assured itself of local counsel's reputation for "competence in matters of the kind involved." *See TriBar Report* § 5.1. If reputation is a matter of concern for the principal opinion giver, then it may consider "unbundling" the opinion letter from that of local counsel. This approach is discussed in the following paragraph of this Report.

129 *Accord* ¶ 8.1; GLAZER & FITZGIBBON § 5.3.3 at 143.

130 The TriBar Report asserts that an indication in the principal opinion giver's opinion that local counsel's opinion is satisfactory in form and substance or that the opinion giver concurs in local counsel's opinion imposes a burden on the principal lawyer to make an independent investigation of the law involved beyond merely satisfying itself that reliance on the opinion is reasonable, based on the reputation of local counsel for competence in matters of the kind involved. *See TriBar Report* § 5.1 n. 99. The ABA Guidelines state that a "concurrence" opinion should not normally be requested. *See ABA Guidelines* § 2.2. The TriBar Report maintains that there is no broadening of the principal opinion giver's responsibility if an opinion letter merely states that the local counsel's opinion is "satisfactory in form and scope" (as opposed to "in form and *substance*") or that the opinion recipient is "justified" in relying on local counsel's opinion. *TriBar Report* § 5.1 n. 99 and accompanying text.

131 *See TriBar Report* § 5.2.

132 An example of the latter would be reliance upon local counsel's opinion that the Agreement has been duly authorized by the Company when the principal opinion giver is giving the remedies opinion.

The Committee does not recommend that the principal opinion giver incorporate local counsel's opinion in the opinion letter of the principal lawyer. The Committee does not conclude, however, that doing so would always be inappropriate. In making a determination as to whether to do so, the principal opinion giver may wish to consider the degree to which the substance of the local counsel's opinion letter is comparable in specialization to that of a "special counsel" as referenced below in note 134 (and accompanying text) and the

(footnote continued on next page)

recipient, as both parties have an interest in assuring that a competent local lawyer is retained. If this procedure is used, the principal opinion giver should not be held to have assumed responsibility either for the advice contained in the opinion letter or the selection of local counsel.[133]

Reliance on Opinion of "Special" Counsel. Considerations similar to those arising in the selection and use of local counsel apply in the retention of special counsel. In *Horne v. Peckham*,[134] the California Court of Appeal held that a lawyer who has no expertise in a specialized matter should not render an opinion in the specialized area, and should refer the matter to a lawyer qualified in that field. The principal opinion giver normally does not furnish an opinion on the same matters as the specialist, even an opinion rendered solely in reliance on the specialist's opinion. The specialist customarily is retained specifically because the principal opinion giver does not have sufficient expertise to render the opinion in question.

Relationship of the Lawyer with the Client and Others. In some cases, the opinion giver may have a relationship with the Company beyond that of "lawyer-client." For example, the opinion giver or a member of its law firm may serve as a director or officer of the Company, may have a close family relationship with an officer, director or principal shareholder, may have or control a significant investment in the Company, or may have some other significant business relationship with the Company (such as landlord-tenant). These relationships should not bear on the ability of the opinion giver to render an opinion because the lawyer-client relationship is not predicated on independence. It is not unusual, however, for such matters to be brought to the attention of the other party to the transaction and its counsel. If the opinion giver chooses to disclose these and other relationships in the opinion letter, it can be done by a simple reference to the facts such as follows:

> We advise you that _____, a member of our firm, is a director of the Company [and {in the event material stock ownership exists} that members of the firm own beneficially _____ {common} shares of the Company].

(footnote continued from previous page)

ease with which the conclusions of local counsel (including all assumptions, limitations and exclusions) may be incorporated into the principal opinion letter.

133 *See* Appendix 4 ("Report of the Threshold Subcommittee") to the Remedies Report, Part III, Section C.2.

134 97 Cal. App. 3d 404, 158 Cal. Rptr. 714 (1979). Note that *Horne v. Peckham* has been overruled on other grounds by *ITT Small Business Corp. v. Niles*, 9 Cal. 4th 245, 36 Cal. Rptr. 2d 552 (1994), which was overruled four years later by *Jordache v. Brobeck, Phleger & Harrison*, 18 Cal. 4th 739, 76 Cal. Rptr. 2d 749 (1998). While the standard for referring a matter to a legal specialist still stands, it has not been articulated in any more recent cases. *See also* Musser v. Provencher, 28 Cal. 4th 274, 121 Cal. Rptr. 2d 373 (2002) (allowing one attorney to seek indemnification from another attorney who was a tax specialist for an incorrect opinion from the specialist).

This declaration does not lessen the opinion giver's duties with respect to the opinion.[135]

6. Signature

The procedure typically followed by most law firms is for the opinion letter to be manually signed in the name of the firm. Some law firms follow different practices, such as "XY&Z by A, a partner" or "A on behalf of XY&Z." If the opinion letter is signed only in the firm name, the Committee recommends that the firm maintain a record identifying the signatory.

7. "Back-Up Memorandum" and Internal Review

Some opinion givers memorialize the factual and legal review they have conducted in one or more memoranda. This practice gives the opinion giver a permanent record of the procedures followed in the event portions of the opinion are subsequently questioned. A simple and orderly procedure is to describe for each opinion clause the various steps taken to support the conclusions expressed.

Some law firms have adopted policies for internal review of their closing opinions prior to delivery. These reviews take different forms. Some firms require another lawyer or lawyers experienced in the legal matters covered by the opinion to review the underlying Agreement, the various factual certificates and the "back-up" memoranda to confirm that each legal conclusion has been properly reached and documented. Some firms utilize a separate "legal opinion" committee to review each opinion as to form and substance. This approach helps assure consistency in the form of the firm's opinions. Other firms use variations of these procedures, or other procedures as determined to be appropriate for them. The objective of any review should be to confirm that appropriate diligence was performed and to identify issues or problems that may require further thought or review.

V. CERTAIN COMMON OPINIONS AND SPECIAL ISSUES UNDER CALIFORNIA LAW AND PRACTICE

This Report does not attempt to provide an exhaustive list of the many opinions that may be given in business transactions. Instead, this part of the Report identifies and addresses some of the most common opinions. In each case, emphasis is given to issues with special relevance to California.[136] In addition, the discussion includes the Committee's understanding of current customary practice and illustrative text for each opinion.

The Committee is aware that California opinion givers have varying levels of familiarity with other major opinion reports and base their own opinion practices to varying degrees on their understanding of those reports. Summary references are made to one or more of those reports

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135 The Committee is of the view that the opinion giver is not required to disclose these relationships. *See ABA Guidelines* § 2.3.

136 The corresponding portion of the 1989 Report referred to sources from which parts of it were adapted. The Committee has taken a fresh look at the opinions covered in this Section and the current practices applicable to them. In that context, the Committee does not believe it necessary to make specific reference to those sources, while noting that current practice no doubt has been shaped by them.

where the Committee believes that readers of this Report may find them useful. In those instances, the purpose is to provide a point of reference rather than to distinguish or (unless specifically stated) differ from the views expressed in those reports.

A. Corporate Status

Opinions on corporate status are common in lending, securities and other corporate transactions. Corporate good standing is necessary, among other reasons, to preserve a corporation's right to prosecute, defend or appeal an action in California courts. Purchasers of a corporation's securities and others seeking to do business with a corporation often seek an opinion that the corporation is in good standing with the Secretary of State and the Franchise Tax Board. An opinion on corporate status is almost always requested by lenders proposing to make loans to a corporation.

A typical opinion regarding corporate status reads as follows:

> The Company is validly existing and in good standing under the laws of the State of California.

1. Special Note on Due Incorporation/Organization

Historically, corporate status opinions included an opinion to the effect that the Company was "duly incorporated." "Duly incorporated" in California means that the corporation complied with the statutory requirements under the Corporations Code to become a California corporation at the time of its formation.[137] Due incorporation is evidenced in California by the filing of the initial articles with, and acceptance of the filing by, the Secretary of State. The Committee believes that opinion practice in California is evolving away from providing "duly incorporated" opinions, particularly for older corporations, to providing a "validly existing" opinion (discussed below). However, the remainder of this Section provides an overview of the "duly incorporated" opinion because, despite the above-noted trends, some California lawyers continue to be asked for the opinion.

The "duly incorporated" opinion does not cover any action by the Company after the initial articles have been filed and certified. Since the "duly incorporated" opinion only covers the Company's status at the time of incorporation, it never stands alone. Rather, it is routinely paired with an opinion about the Company's current status (*e.g.*, validly existing or in good standing, each as discussed elsewhere in this Section).

The Corporations Code provides that a copy of the articles certified by the Secretary of State is conclusive evidence of due incorporation.[138] Therefore, opinion givers rely solely on a

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137 *See also* Part IV, Section D.5 of this Report and Part VI, Section B of this Report.

138 CAL. CORP. CODE § 209.

certified copy of the initial articles to deliver the "duly incorporated" opinion for a California corporation.

A less-desirable alternative to the "duly incorporated" opinion as to corporate status is the "duly organized" opinion. The term "duly organized" was historically understood to refer to the initial corporate actions taken after the Company had been incorporated: appointment of the board of directors, the adoption of its bylaws, and the election of officers. These actions (unless the initial directors are named in the articles) must be taken before the Company can take any additional corporate action. If the Company has not been duly organized, all corporate actions otherwise apparently taken may be subject to subsequent invalidation. To deliver a "duly organized" opinion, opinion givers rely on an examination of the Company's minute books and one or more officers' certificates certifying those minutes.

The "duly organized" opinion was also historically understood to encompass the original authorization and issuance of shares of the Company. The TriBar Report suggests that the initial issuance of stock is covered by a "duly organized" opinion. The TriBar Report also points out that a corporation's due organization must be based on the laws that existed at the time of organization and, therefore, concludes that the "duly organized" opinion can be onerous if the actions were taken long ago, and is most often rendered when a corporation has been recently organized.[139] Opinion givers may also be asked to render this opinion if they have represented the Company since its incorporation.

The Committee believes that it would be appropriate for an opinion giver to decline to give either of the opinions covered by this subsection, unless the opinion giver was responsible for the Company's incorporation. If an opinion giver elects to do so, the Committee believes that the "duly incorporated" formulation of this opinion is the more common one.

2. Validly Existing

a. What it means

"Validly existing" means that the a corporation has not dissolved or ceased to exist. The adverb "validly" means that a corporation is a *de jure* corporation and not merely a *de facto* corporation. The opinion also means that no dissolution proceedings have been initiated.

b. What sort of information lawyers customarily rely upon to deliver this opinion

To deliver this opinion, opinion givers rely on good standing certificates from the Secretary of State, a review of the minute book (to ensure that no dissolution proceedings have commenced) and an officers' certificate.

139 *TriBar Report* § 6.1.2.

c. Other major opinion reports

The TriBar Report states that the "validly existing" opinion can be given in two ways. First, it can be given as a supplement to a due incorporation or due organization opinion based solely on a certificate from the Secretary of State. Second, it can be given as a stand-alone opinion (instead of the due incorporation opinion) when the statutes in existence and corporate records at the time of incorporation are difficult to locate. In the latter case, the opinion giver examines the articles and certificate from the Secretary of State, but does not necessarily review the corporate record books. The TriBar Report further states that this opinion used alone is growing in acceptance but that doing so for a recently incorporated company is the exception.[140] The Committee concurs in this observation.

3. Good Standing in California

a. What it means

A corporation is in good standing when its charter has not been suspended or forfeited, which for a California corporation can occur from a failure to (1) pay state taxes, (2) file tax returns with the Franchise Tax Board, or (3) file an annual statement with the Secretary of State.

b. What sort of information lawyers customarily rely upon to deliver this opinion

Opinion givers typically rely solely on a good standing certificate from the Secretary of State, as that certificate includes information from the Franchise Tax Board. However, many lawyers also obtain a good standing certificate from the FTB if time permits or if there is otherwise reason to believe that the Company may be delinquent on its filings with the Franchise Tax Board.

4. Good Standing in Other Jurisdictions

California lawyers are often asked to give an opinion on the standing of a foreign corporation. Opinion givers usually give this opinion by relying solely on a good standing certificate from the Company's state of incorporation.

Opinion givers are also often asked to give an opinion on whether the Company is qualified to do business in a foreign jurisdiction. A typical opinion on that point reads as follows:

> The Company has qualified to do business and is in good standing in the state[s] of _____.

This opinion is usually based solely on a certificate from the foreign jurisdiction.

140 *TriBar Report* § 6.1.3.

It is generally accepted that an opinion giver should not be asked for an opinion that the Company is qualified to do business as a foreign corporation in all jurisdictions in which its property or activities require qualification or in which the failure to qualify would have a material adverse effect on the Company.[141] An opinion on qualification to do business in selected states, if rendered at all, is based solely on certificates of public officials. Delivery of those certificates, without an opinion, ordinarily should be sufficient to satisfy the needs of the opinion recipient, thereby making this opinion unnecessary.[142]

B. Corporate Power and Corporate Action

A lender, purchaser of corporate stock or other party who proposes to consummate a significant transaction with the Company is interested not only in its corporate status, but also in its corporate power to enter into the Agreement and to conduct its business generally and the corporate action it has taken to approve the transaction.

1. Corporate Power to Conduct Business and Enter into Agreement

A typical opinion on corporate power for a particular transaction and the general transaction of business reads as follows:

> The Company has the corporate power to enter into and perform the Agreement [and to carry on its business as it is currently being conducted.]

a. What it means

The "corporate power" opinion addresses whether the Company is permitted pursuant to the corporate law of its jurisdiction of incorporation and its articles to engage in a specified activity or enter into a specified agreement. The corporate power opinion means that the relevant action or agreement is not *ultra vires*. The opinion does not speak to whether the action is restricted by laws other than the corporate law of the jurisdiction of incorporation, such as laws requiring licenses or permits.

Since the adoption of the GCL in 1977, the "corporate power" opinion provides little problem for California corporations that do not have limitations specified in their articles. Corporations Code Section 206 permits a corporation, other than a corporation subject to the

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141 *See 1989 Report* at 27; *TriBar Report* § 6.1.6; *ABA Guidelines* § 4.1.

142 *See ABA Guidelines* § 4.1:

> An opinion giver should not be asked for an opinion that the opinion giver's client is qualified to do business as a foreign corporation in all jurisdictions in which its property or activities require qualification or in which the failure to qualify would have a material adverse effect on the client. Analysis of the "doing business" requirements of each jurisdiction in which the client has property or conducts activities would require an extensive factual inquiry and a review of the law of jurisdictions as to which the opinion giver cannot reasonably be expected to have expertise. This analysis rarely would be cost-justified.

California Banking Law or a professional corporation, and subject to compliance with other applicable laws, to engage in any business activity.[143] Those corporations subject to the California Banking Law or the laws governing professional corporations may engage in any activity not prohibited by the respective statutes and regulations to which the corporation is subject.[144] Corporations Code Section 207 provides that a corporation has all the powers of a natural person in carrying out its business activities and lists a number of the powers included in that broad authorization.[145] Corporations organized or governed by other statutes, however, may have restricted powers.

Historically, the corporate power opinion included a reference to "authority" in addition to "power." Because of concerns that a reference to "authority" could lead to a more expansive interpretation of the "corporate power" opinion, current practice appears to be moving away from including "authority."[146] However, the "corporate power" opinion is generally understood to have the same meaning whether or not "authority" is included and, to the extent that the word "authority" is included, it is generally understood to be limited to "corporate authority" even without the modifier "corporate" immediately preceding the word "authority."[147] In addition, the corporate power opinion has historically included an express opinion that the subject corporation has the corporate power to own and operate its assets. Current practice seems to be evolving away from this form of opinion in favor of limiting the "corporate power" opinion to the Company's power to carry on its business as it is currently conducted.

b. What sort of information lawyers customarily rely upon to deliver this opinion

A review of the articles should be conducted to identify any provision restricting corporate power. In addition, opinion givers also confirm that the Company is not subject to the California Banking Law, is not a professional corporation, and is not subject to any limitation under "any other applicable laws . . . ."[148] For example, the corporate power to reacquire shares, granted by Corporations Code Section 207(d), is subject to the provisions of Section 510 of Corporations Code, and the corporate power to enter into contracts and guarantees, granted by Section 207(g), is subject to the provisions of Section 315 restricting loans to, or guarantees of the obligations of, directors and officers. In addition, an understanding of the business conducted by the Company is necessary, which is customarily based upon a description contained in a disclosure document or in one or more officers' certificates.

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143 CAL. CORP. CODE § 206 (Section 206 applies to corporations formed prior to the effective date (January 1, 1977) of the GCL). *See* CAL. CORP. CODE § 2303.

144 CAL. CORP. CODE § 206.

145 *Id.* § 207.

146 *See* GLAZER & FITZGIBBON § 8.2.

147 *Id.*

148 CAL. CORP. CODE § 206.

c. What the opinion does not cover

The "corporate power" opinion does not extend to other California (or other state), federal or local authorizations and approvals. An opinion as to such authorization and approval is much more expansive than the "corporate power" opinion. Among other things, it requires a level of knowledge about, and diligence regarding, the business of the Company that is not customarily undertaken to deliver the "corporate power" opinion. In addition, the "corporate power" opinion does not address provisions of corporate laws that may have collateral effects, such as the imposition of liability on directors who approve an interested-party transaction, appraisal rights or rights of shareholders to approve a transaction.[149]

2. Due Authorization, Execution and Delivery

A typical "duly authorized" opinion reads as follows:

> The Agreement has been duly authorized by all necessary corporate action on the part of the Company and has been duly executed and delivered by the Company.

a. What it means

"Duly authorized" means that the board of directors (or a duly authorized committee of the board, and, if necessary, the shareholders) of the Company have taken all necessary action to approve the execution, delivery and performance of the Agreement and that the Company has complied with the procedures applicable to obtaining such authorization. "Duly executed" means that the officers who have signed the documents on behalf of the Company were authorized to take such action and that those officers were current officers of the Company at the time of execution. "Duly delivered" means that the Company has delivered the Agreement to the other party or parties to the transaction to create a binding contract. The phrase "duly authorized by all necessary corporate action on the part of the Company" may be preferable to "duly authorized" alone, as the latter might be construed to imply authorization under law other than the GCL or by a governmental regulatory body or by another third party whose consent may be required, although the Committee does not believe that any such inference is justified or appropriate.

b. What sort of information lawyers commonly rely upon to deliver this opinion

The "duly authorized" opinion requires a review of the articles and bylaws of the Company and of the California Corporations Code to determine the approvals required and the procedures for obtaining them, including notice provisions for meetings and any restrictions on the use of written consents. The opinion also may involve a review of the minute book to verify that the action has in fact been taken. Opinion givers often alternatively rely on a secretary's

149 *See* GLAZER & FITZGIBBON § 8.2.

certificate certifying the adoption of the relevant resolutions.[150] The opinion giver is entitled to assume (based upon the certificate), without stating, that the directors approving the action were duly elected and that, in approving the transaction, required procedures (e.g., presence of a quorum and the giving of appropriate notice) were satisfied.[151] Verification of any required shareholder approval involves a review of the Company's compliance with applicable procedures for obtaining such approval, such as the presence of a quorum and the giving of appropriate notice or compliance with applicable shareholder consent procedures. This is also usually accomplished through a secretary's certificate certifying the adoption of the relevant resolutions.

The "duly executed" opinion involves a review of the minutes or reliance upon an officers' certificate to establish that the officers executing the documents on behalf of the Company have been validly elected, that they are or were officers of the Company at the time of execution, and that they were in fact authorized to execute the documents on behalf of the Company. While the "duly executed" opinion also addresses the genuineness of the signatures of the signing officers, such genuineness is expressly or implicitly assumed.

Giving an opinion that a document has been "duly delivered" generally means that the opinion giver is present at the delivery of the signed Agreement or otherwise satisfied as to the implementation of procedures for actual delivery.

c. What the opinion does not cover

In rendering the "duly authorized" opinion the opinion giver assumes that the directors or officers of the Company, in approving a transaction or agreement, are in compliance with their fiduciary duties. Fiduciary duty questions are largely factual and subjective in nature. By custom, opinion givers assume (without stating) that the board of directors has fulfilled any fiduciary duties that are applicable to the approval of the Agreement (as opposed to specific procedures required by the articles, bylaws or the GCL).

The "duly authorized" opinion does not include an opinion as to the sufficiency of any disclosure document used to solicit shareholder approval of the transaction. Some lawyers choose to state expressly this assumption in situations in which fiduciary duty issues are particularly sensitive (*e.g.*, agreements entered into as anti-takeover devices) or with respect to the sufficiency of a proxy solicitation.[152] The assumption, however, is not appropriate if the opinion giver knows it is incorrect or that reliance on it would be unreasonable.[153]

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150 *See* CAL. CORP. CODE § 314; Part IV, Section D.3 of this Report ("Officers Certificates').

151 *See* CAL. CORP. CODE § 314 (providing that a copy of a resolution certified by "a person purporting to be" the secretary or an assistant secretary "is prima facie evidence of the adoption of such … resolution or of the due holding of such meeting and of the matters stated therein … ").

152 *See* GLAZER & FITZGIBBON § 9.3.

153 *See* Part IV, Section B.6 of this Report.

d. Special issues under California law: Section 2115 and SB 1306

There are two special issues that the Committee believes are worth highlighting in connection with the "duly authorized" opinion: (1) the impact of Corporations Code Section 2115 pursuant to which certain corporate governance requirements of California law could be applicable to a corporation formed under the laws of a state other than California (referred to colloquially as a "quasi-foreign corporation"); and (2) the impact of the enactment in August 2004 of SB 1306, which amended the GCL to permit shareholder and director meetings to be conducted by "electronic transmission by and to the corporation" and to permit corresponding notices of such meetings, in both cases if specified procedures are followed.[154]

For the most part, this Report seeks to address issues of law applicable to California corporations entering into business transactions governed by the laws of the State of California. Corporations Code Section 2115 does not apply to California corporations. As a practical matter, however, it is not unusual for California lawyers to render legal advice to a corporate client doing business in California (possibly even based in California) but incorporated under the laws of another state. In those cases, the opinion giver may find itself rendering a legal opinion for which application of Section 2115 could be implicated in a "duly authorized" opinion. If so, the opinion giver will need to be aware of the provisions of the Corporations Code specified in Section 2115 as possibly being applicable to a "quasi-foreign corporation." The Committee notes that the intricacies of Section 2115 and the impact of the Section on legal opinions rendered in connection with business transactions are beyond the scope of this Report, although it should be noted that if a foreign corporation meets the three-factor test for the application of Section 2115 (generally that more than 50% of its property, payroll, and sales are in or from California) *and* more than half of its outstanding voting securities are held of record by California residents, *and* the corporation is *not* publicly-traded, then each of the provisions of the Corporations Code referenced in Section 2115 should be carefully reviewed to determine its applicability to the Company's authorization of the Agreement and to the enforceability of the Agreement.[155]

SB 1306 was signed into law on August 23, 2004 and became effective on January 1, 2005. Its purpose is to permit the use in corporate proceedings of emerging technologies of communication, including the Internet and the world wide web. The Committee played an active role in the drafting of, and legislative deliberations on, SB 1306. It is not, however, in a position to speculate as to what the customary opinion practice will become with respect to use of those technologies. No doubt customary practice will develop in due course as to the diligence of opinion givers rendering due authorization opinions in transactions where "emerging

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154 *See* 2004 Cal. Stats. ch. 254.

155 For analyses of Section 2115 of the Corporations Code, see 3 BALLANTINE & STERLING, CALIFORNIA CORPORATION LAWS § 393 (R. Bradbury Clark, editor) (4th ed. 2004) [hereinafter BALLANTINE & STERLING]; 2 Harold Marsh, Jr., R. Roy Finkle and Larry W. Sonsini, MARSH'S CALIFORNIA CORPORATION LAW § 26.04 (4th ed. 2004) [hereinafter MARSH'S CALIFORNIA CORPORATION LAW].

In VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108 (Del. Sup. Ct. 2005), the Delaware Supreme Court ruled that under the internal affairs doctrine and the federal Constitution, the voting rights of the shareholders of a Delaware corporation are governed by Delaware law and not by California law, notwithstanding the possible application of Section 2115 to a Delaware corporation headquartered in California.

technologies" are employed in authorizing a business transaction. Until then, opinion givers rendering a "duly authorized" opinion for a Company that follows the procedures permitted by SB 1306 will face special challenges in determining that the Company has satisfied the requirements for doing so.

C. No Violation Opinion

Historically, the "no violation" opinion was referred to as the "no conflict" opinion -- that is, the execution and delivery of the Agreement and the performance by the Company of its obligations thereunder do not "conflict with" the articles, bylaws, agreements, judgments, orders or laws. Due to the imprecise nature of the phrase "conflict with," a practice has developed to use the concepts of "violation," "breach" or "default" instead, because such concepts are more precise and understandable. A typical "no violation" opinion reads as follows:

> The execution and delivery of the Agreement and the performance by the Company of its obligations under the Agreement do not (i) violate the Company's articles or bylaws, (ii) constitute a default under or [material] breach of any agreement identified on Schedule 1, (iii) violate any judgment, order or decree of any court or arbitrator identified on Schedule 2, or (iv) violate any U.S. federal or California law, rule or regulation that in our experience is typically applicable to transactions of the nature contemplated by the Agreement or generally applicable to companies engaged in the same line of business as the Company [, which violation in the case of clause (iv) would materially and adversely affect the Company].

As a general rule, the "no violation" opinion is expressed in a single paragraph. This Report, however, separates each of the subparts of the opinion and discusses them separately. This section of the Report also discusses other related opinions that are sometimes requested.

The qualification in clause (iv) of the above "no violation" opinion, "that in our experience is typically applicable to transactions of the nature contemplated by the Agreement or generally applicable to companies engaged in the same line of business as the Company," is, as a matter of customary practice, implicit and need not be stated. If the opinion giver wishes to state the qualification, the qualification is typically included in the forepart of the opinion letter in the discussion of the law covered by the opinion letter.[156]

The bracketed portion of clause (iv) of the above "no violation" opinion, relating to the material adverse effect on the Company, is controversial. Many opinion recipients and their counsel do not accept this qualification. The exception places the opinion giver in the position of determining an essentially business, rather than legal, conclusion of what is material to the Company. However, it is included in the sample "no violation" opinion above because many opinion givers now include it, as a matter of course, in their opinions. Whether the practice will become widespread is a matter of speculation.

156 *See* Part IV, Section D.3 and Part V, Section C.4 of this Report.

1. No Violation — Articles and Bylaws

> The execution and delivery of the Agreement and the performance by the Company of its obligations under the Agreement do not (i) violate the Company's articles or bylaws ….

a. What it means

The "no violation" opinion with respect to the Company's articles and bylaws is intended to provide the opinion recipient with the comfort that neither the execution and delivery by the Company of the Agreement nor the performance by the Company of the terms of the Agreement, including future obligations, will violate its articles or bylaws. The opinion means that, as of the date of the opinion, the agreement of the Company to perform future obligations does not violate the articles or bylaws and that the mere passage of time would not result in a violation of the articles or bylaws by the Company if it performs those obligations under the Agreement. This opinion is largely duplicative of the "corporate power" opinion, due authorization opinion and related aspects of the remedies opinion; in general, those opinions could not be given if the execution, delivery or performance of the Agreement would violate the articles or bylaws. Nonetheless, a practice has developed to provide this opinion separately. Often, the form of opinion requested contains language that the terms of the Agreement "do not conflict with" the articles or bylaws. Although the 1989 Report contemplated the use of that language, the phrase "conflict with" is imprecise. The Committee thus believes that the better practice is not to use that terminology.

b. What sort of information lawyers customarily rely upon to deliver this opinion

A review and understanding of the Agreement and the articles and bylaws are required to deliver this opinion. The opinion giver generally obtains a certified copy of the articles from the Secretary of State of the applicable state and a copy of the bylaws certified by an appropriate officer of the Company.

c. What the opinion does not cover

The "no violation" opinion is not an opinion that no adverse consequences will result from the Company's entering into and performing its obligations under the Agreement. When the opinion covers performance of the Agreement, the opinion does not address whether (i) the Company's future performance of those obligations will satisfy all conditions in the Agreement, (ii) facts will exist at a future time that could make the Company's future performance of those obligations a violation of the articles or bylaws, or (iii) a change in the law could make the Company's future performance of its obligations a violation of the articles or bylaws.

d. Other major opinion reports

TriBar Report: The TriBar Report states that the practice of drafting the opinion to cover these charter documents is well established despite the fact the opinion adds nothing to other

opinions commonly given and concludes that, while some members of the TriBar Opinion Committee believe the opinion should be eliminated to avoid redundancy, either approach is acceptable.[157] The Committee concurs.

2. No Violation — Material Agreements

> The execution and delivery of the Agreement by the Company and the performance by the Company of its obligations under the Agreement do not … (ii) constitute a default under or [material] breach of any agreement identified on Schedule 1 ….

a. What it means

The "no violation" opinion with respect to the Material Agreements is intended to provide the opinion recipient with the comfort that neither the execution and delivery by the Company of the Agreement nor the performance by the Company of the terms of the Agreement, including future obligations, breaches or constitutes a default under identified Material Agreements of the Company. The opinion means that, as of the date of the opinion, the agreement of the Company to perform future obligations does not breach or constitute a material default of the Material Agreements and that the mere passage of time would not result in such a breach or default if the Company performed those obligations under the Agreement.

Early in the negotiation of the opinion, an agreement should be reached on a method and/or criteria for identifying the Material Agreements. The customary method is to limit the opinion to the contracts listed in (i) an exhibit to the Agreement, (ii) a filing by the Company with the SEC, (iii) an officers' certificate, or (iv) an attachment to the opinion letter. Inclusion of the qualification "material" before the word breach is also one that is negotiated on a case-by-case basis.

Some opinion recipients may request that the opinion be drafted to cover agreements to which the Company is a party and also agreements to which it is otherwise subject. This broader opinion would extend the coverage of the opinion to agreements that the Company did not affirmatively execute but to which it may have become subject, for example a collective bargaining agreement assumed by operation of law by the Company as a result of an acquisition. This raises troublesome diligence problems. The Committee is of the view that this broader opinion should be resisted by the opinion giver.

b. What sort of information lawyers customarily rely upon to deliver this opinion

Typically, a list of the agreements covered by the opinion (referred to in this Report as "Schedule 1") is prepared by the Company in consultation with the opinion recipient. Where Schedule 1 has not been prepared in consultation with or approved by the opinion recipient, the

157 *TriBar Report* § 6.5.1.

opinion preparers often will obtain an officers' certificate identifying the agreements listed on Schedule 1 as agreements material to the Company. A review and understanding of the Agreement and the listed agreements are required to determine whether a breach or default has occurred.[158]

c. Assumptions and exceptions

The opinion giver may consider including the following assumption in the forepart of the opinion letter:

> With regard to our opinion in paragraph ___ below concerning defaults under and [material] breaches of any agreement identified in Schedule 1, we have relied solely upon: (i) a list supplied to us by the Company of material agreements to which the Company is a party, or by which it is bound, a copy of which is attached hereto as Schedule 1 (the "Material Agreements"); and (ii) an examination of the Material Agreements in the form provided to us by the Company. We have made no further investigation.[159] With regard to the Material Agreements, we have assumed that they would be interpreted in accordance with their plain meaning.[160]

158 See the discussion of customary diligence in the examination of documents in Part IV, Section D.3 of this Report.

159 The Committee does not believe that the disclaimer "[w]e have made no further investigation" is necessary because it is generally understood. Some lawyers include exceptions and assumptions regarding defaults under Material Agreements such as:

> With regard to our opinion in paragraph ___ below with respect to defaults under and [material] breaches of any Material Agreement, we express no opinion as to: (i) financial covenants or similar provisions therein requiring financial calculations or determinations to ascertain compliance; (ii) provisions therein relating to the occurrence of a "material adverse event" or words of similar import; or (iii) any statement or writing that may constitute parol evidence bearing on interpretation or construction of any Material Agreement.

The authors of Glazer & FitzGibbon, citing several bar association reports, observe that the "no breach or default" opinion covers financial covenants and that opinion preparers have the responsibility of identifying the relevant financial covenants and other financially-oriented provisions in the contracts being addressed, but that opinion preparers customarily obtain and base the opinion on a certificate from an appropriate officer of the Company or the Company's independent accountants that the transaction will not violate the financial covenants and similar provisions specified in the certificate. GLAZER & FITZGIBBON § 16.3.5. In the absence of a disclaimer or an assumption, the Committee is of the view that a "no violation – material agreements" opinion includes the financial covenants of Material Agreements, but that opinion preparers customarily rely upon a certificate of an appropriate officer of the Company or the Company's independent accountants, without independent verification, regarding compliance with the relevant financial covenants in Material Agreements.

160 Historically, opinion givers have assumed that Material Agreements "are governed by the substantive law of California." The assumption stated in the text has gained increasing acceptance, and the Committee endorses it as the preferred assumption. *See TriBar Report* § 6.5.6. The TriBar Report states that where the agreements reviewed are governed by the law of jurisdictions not specified for coverage in the opinion letter, the opinion preparers are entitled to assume, without so stating in the opinion letter, that those contracts

(footnote continued on next page)

Some opinion givers seek to include a controversial qualification to this opinion that limits coverage to violations that have a material adverse effect on the Company. The qualification presents unique problems for the "no violation" opinion relating to Material Agreements and thus is rarely accepted. One purpose of the opinion is to confirm that the provisions of the Agreement between the Company and the opinion recipient do not interfere with another party's contractual relationship with the Company pursuant to one or more Material Agreements. That interference could potentially lead to claims by that other party against the opinion recipient (e.g., a claim alleging tortious interference with a contractual relationship). A qualification to the opinion regarding whether such a violation has a material adverse effect on the Company defeats the purpose of the opinion since the opinion giver could exclude tortious interference claims arising out of non-material agreements about which the opinion recipient could be subjected to significant liability. Among other things, a potential claim of that nature, while not having a material adverse effect on the Company, could still frustrate the purposes of the parties in entering into the Agreement or otherwise have an adverse effect on the opinion recipient.

d. What the opinion does not cover

As previously noted, the "no violation" opinion is not an opinion that no adverse consequences will result from the Company's entering into and performing its obligations under the Agreement. When the opinion is drafted to cover performance, the opinion does not address whether the Company's future performance of those obligations will satisfy all conditions in the Agreement, or whether facts will exist in the future that could make the Company's future performance of those obligations a violation of the Material Agreements.

e. Other major opinion reports

TriBar Report: The TriBar Report states that one commonly used approach is to limit the "no violation - material agreements" opinion to the contracts listed in an exhibit to the Agreement, in a filing by the Company with the SEC, or in an attachment to the opinion. The TriBar Report further indicates that, since agreements covered by the no violation opinion may be governed by the law of jurisdictions not covered in the opinion letter, the opinion giver may assume, without stating in the opinion letter, that those agreements would be interpreted in accordance with their plain meaning unless the opinion giver identifies a problem, in which case the opinion giver may wish to obtain an opinion from local counsel.[161]

(footnote continued from previous page)

would be interpreted "in accordance with their plain meaning" (unless the opinion preparers identify a possible problem, in which event they may want to obtain an opinion from local counsel).

161 *See TriBar Report* §§ 6.5.5-6.5.6.

3. No Violation — Court Orders

> The execution and delivery of the Agreement and the performance by the Company of its obligations under the Agreement do not … (iii) violate any judgment, order or decree of any court or arbitrator identified on Schedule 2 ….

a. What it means

The "no violation" opinion with respect to judgments, orders or decrees is intended to provide the opinion recipient with the comfort that neither the execution and delivery by the Company of the Agreement nor the performance by the Company of the terms of the Agreement, including future obligations, violates any of the identified judgments, orders or decrees of a court or arbitrator. By customary usage, the opinion means that, as of the date of the opinion, the agreement to perform those future obligations by the Company does not violate the judgments, orders or decrees of any court or arbitrator identified on a list (referred to in this Report as "Schedule 2"), and that the mere passage of time would not result in a violation of those identified judgments, orders or decrees by the Company if it performs its obligations under the Agreement. The 1989 Report utilized language in the opinion that covered judgments, orders or decrees of any court or arbitrator, known to the opinion giver, to which "the Company is a party or is subject." Current practice is not to use the language "or is subject" because it extends coverage of the opinion to proceedings that are applicable to the Company but in which it has not been joined as a named party (e.g., an industry-wide court order), of which the opinion giver may not be aware.

b. What sort of information lawyers customarily rely upon to deliver this opinion

As with Schedule 1 for Material Agreements, Schedule 2 is prepared by the Company in consultation with the opinion recipient. Where Schedule 2 is not prepared in consultation with or approved by the opinion recipient, the opinion preparers often will obtain an officers' certificate identifying the judgments, orders and decrees of courts or arbitrators listed on Schedule 2 as material to the Company. A review of the Agreement and any identified judgments, orders and decrees is required to determine if there is a violation. Many opinion givers conduct a poll of lawyers of the firm working on the transaction to determine whether any additional judgments, orders or decrees should be added to Schedule 2.[162] A search of court or administrative agency records is not customarily conducted for the purpose of rendering this opinion.

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162 These additional procedures correspond to those used in the context of the separate but related confirmation as to the absence of litigation, in which case they are generally less discretionary. *See* Part V, Section C.8 of this Report.

c. Assumptions and exceptions

If the opinion giver limits its review of judgments, orders, and decrees to those listed on Schedule 2, as suggested above, then the opinion giver may consider including the following limitation in the forepart of the opinion letter:

> With regard to our opinion in paragraph ___ below concerning violations of any judgment, order or decree of any court or arbitrator identified on Schedule 2, we have relied solely upon an examination of the judgments, orders and decrees listed on Schedule 2 in the form provided to us by the Company. We have made no further investigation.

d. What the opinion does not cover

As previously noted, the "no violation" opinion is not an opinion that no adverse consequences will result from the Company's entering into and performing its obligations under the Agreement. When the opinion covers performance, the opinion does not address whether the Company's future performance of those obligations will satisfy all conditions in the Agreement, or whether facts will exist at a future time that would make the Company's future performance of those obligations a violation of the identified judgments, orders or decrees.[163]

e. Other major opinion reports

TriBar Report: The TriBar Report states that a commonly used approach is to list court orders covered by the opinion. An opinion recipient will sometimes request that the opinion be drafted to cover court orders in proceedings to which the Company is a party and orders to which the Company is otherwise subject. This broader opinion would extend coverage of the opinion to proceedings in which the Company has not been joined as a named party, such as *ex parte* proceedings or industry-wide court orders. The TriBar Report indicates that the expansion of the opinion in this manner can provide troublesome diligence problems for the opinion giver since such court orders may, if not listed on Schedule 2, be unknown to the opinion giver or even to the Company, and the opinion giver should consider the implications. The Committee agrees, and is of the view that the broader opinion should be resisted by the opinion giver.

163 *See generally TriBar Report* § 6.5.4.

4. No Violation — Applicable Law

> The execution and delivery of the Agreement and the performance by the Company of its obligations under the Agreement do not … (iv) violate any U.S. federal or California law, rule or regulation that in our experience is typically applicable to agreements similar to the Agreement, transactions of the nature contemplated by the Agreement, or generally applicable to companies engaged in the same line of business as the Company [, which violation in the case of this clause (iv) would materially and adversely affect the Company].

a. What it means

The "no violation" opinion with respect to applicable law provides the opinion recipient with comfort that neither the execution and delivery by the Company of the Agreement nor the performance by the Company of its obligations under the Agreement, including future obligations, results in any fine, penalty or other similar sanction against the Company under any law, rule or regulation typically applicable to the opinion giver's client, the transaction or the Agreement to which the opinion relates. By customary usage, the opinion means that, as of the date of the opinion, the agreement by the Company to perform future obligations under the Agreement would not result in any fine, penalty or other similar sanction against the Company typically applicable to the transaction or the Company and that the mere passage of time would not result in any fine, penalty or other similar sanction against the Company.

A controversial qualification to this opinion is the bracketed language limiting coverage by reference to a material adverse effect on the Company. Many opinion recipients and their counsel do not accept this limitation since the opinion is already limited to the specific transaction to which the opinion relates. Also, the qualification places the opinion giver in the position of determining an essentially business, rather than legal, conclusion as to what is material to the Company. Many opinion givers, however, insert the qualification as a matter of course in this opinion.

b. What sort of information lawyers customarily rely upon to deliver this opinion

A review and understanding of the Agreement is necessary to determine whether the execution, delivery, consummation and performance of the Agreement violates any law, rule or regulation typically applicable to the Agreement, the transaction, or the Company. To give this opinion, the opinion preparers usually have a general understanding of the laws that apply to these types of transactions and to the Company, or, in appropriate cases, conduct legal research

or take other reasonable steps to achieve comfort on issues they recognize as relevant to the opinion.[164]

c. Assumptions and limitations

The opinion giver may consider including the following limitations in the forepart of the opinion letter, if relevant to the transaction:

> We are not rendering any opinion as to any statute, rule, regulation, ordinance, decree or decisional law relating to [_____.][165]
>
> Furthermore, we express no opinion with respect to compliance with local or municipal law, antitrust, environmental, land use, securities, tax, pension, employee benefit, margin, insolvency, fraudulent transfer or investment company laws or regulations, nor compliance by the Company's board of directors or shareholders with their fiduciary duties.[166]

164 *See* Part IV, Section D.3 of this Report; Appendix 8 ("Application of Customary Practice to the Remedies Opinion") to Remedies Report, Section III(B).

165 This list would commonly include laws that are reasonably related to the opinions given in the opinion letter (and not excluded by the following sentence in the box) but as to which the opinion giver disclaims coverage. If the recipient insists on receiving an opinion on such laws, then special counsel may have to be engaged.

166 *See* Part IV, Section D.3 of this Report, notes 112 and 113, and Part V, Section B.2.c of this Report (discussion of the exclusion for fiduciary duties). *See also TriBar Report* § 6.6. Limitations on the law covered are by custom understood to apply whether or not stated. *See ABA Principles* § II(D) (". . . some laws (such as securities, tax, and insolvency laws) are understood as a matter of customary practice to be covered only when an opinion refers to them expressly."). For further discussion, see Appendix 10 ("Report of the Exceptions Subcommittee) to the Remedies Report at "Further Notes." Nevertheless, because counsel may disagree on the list of laws excluded from the laws covered by this opinion, opinion givers often list the laws not addressed by this opinion. Care should be exercised in listing the laws not addressed by this opinion, given the inference that may be drawn by the opinion recipient that laws not listed as excluded but relevant to the opinion are included.

d. Other major opinion reports

TriBar Report: The TriBar Report indicates that a "no violation" opinion with respect to applicable laws is understood as a matter of customary practice not to cover all laws and that the laws covered will depend on the nature of the transaction and the parties to it and would be subject to what a lawyer exercising customary diligence would reasonably recognize as being applicable. In particular, the opinion is understood to exclude local law, such as city ordinances and county zoning regulations that are adopted by political subdivisions below the state level.[167]

5. No Violation — Margin Regulations

The "no violation" opinion with respect to applicable law is also generally understood not to cover compliance with margin regulations. The opinion giver is therefore sometimes asked to give separate opinions on these matters. A typical opinion reads as follows:

> The [execution and delivery of the Agreement and the performance by the Company of its obligations under the Agreement] [extensions of credit provided by the Agreement and the use of the proceeds of the {loan}{securities} by the Company {borrowed}{issued} and applied in the manner contemplated by, and subject to the limitations contained in, the Agreement], do not violate Regulation T, U or X of the Board of Governors of the Federal Reserve System.

This opinion is usually given as a separate opinion. The Committee believes that it is appropriate to give these opinions where the transaction presents issues under these laws and regulations and the opinion giver has sufficient familiarity with them. Opinions on compliance with margin regulations are often difficult to render because of the lack of definitive interpretations on many issues (and the opacity of those interpretations that do exist), as well as the fact that much of the learning on the subject of Regulations T, U and X is a matter of "market practice" or "lore."

a. What it means

In debt financing transactions, the lenders or purchasers often request an opinion regarding compliance with margin regulations.[168] The margin regulations are a complex set of

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167 *TriBar Report* § 6.6.

The Accord (¶ 16) indicates that this opinion is understood to mean that the execution and delivery by the Company of, and the performance by the Company of its obligations under, the Agreement are not prohibited by (and do not subject the Company to any fines, penalties or similar sanctions under) any statutory regulation of the opining jurisdiction that a lawyer in the opining jurisdiction exercising customary professional diligence would reasonably recognize as being directly applicable to the Company, the transaction or both.

168 For a thorough discussion on this topic, see 22 Charles Rechlin, SECURITIES CREDIT REGULATION (2d ed. 2001).

regulations, adopted by the Federal Reserve Board pursuant to Section 7 of the Securities Exchange Act of 1934 (as amended, the "1934 Act").[169] Those regulations govern the extension, maintenance and arranging of credit relating to securities. The opinion means that the agreement of the Company to perform those future obligations does not violate Regulation T, U or X of the Board of Governors of the Federal Reserve System as of the date of the opinion, not when the Company actually performs the obligations.

Regulation T regulates extensions of credit by broker-dealers to purchase, carry or trade in securities, and imposes, among other standards, initial margin, payment, account management and recording rules.[170] Regulation U imposes credit restrictions on banks and other lenders (other than broker-dealers) that extend credit for the purpose of buying or carrying margin stock if the credit is secured, directly or indirectly, by margin stock.[171] Among other restrictions, it limits any such loan to a percentage (currently 50%) of the current market value of the stock securing it.[172] Regulation X extends the margin regulations to margin borrowing by U.S. persons (and foreign persons controlled by or acting on behalf of, or in conjunction with, U.S. persons) from either domestic or foreign lenders.[173]

b. What sort of information lawyers customarily rely upon to deliver this opinion

The Company may be asked to represent and/or covenant (in the corresponding section of the Agreement) that the proceeds of loans or the issuance of debt securities will not be used to purchase or carry securities or margin stock and that margin stock does not constitute more than 25% of the value of its assets. The Company also may be asked by the lenders to undertake the delivery of a form certifying as to the Company's use of the proceeds (*e.g.*, Form FR U-1 or FR G-1 under Regulation U). If the loan or securities are secured by margin stock, the opinion preparers should obtain an officers' certificate or other information as to the market value of the stock.

c. Assumptions and exceptions

In most cases, these opinions assume the accuracy of the Company's representations referred to in the preceding paragraph, but are without other exceptions. Since the analysis can

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169 15 U.S.C. §§ 78a - 78mm.

170 *See* Credit By Brokers and Dealers (Regulation T), 12 C.F.R. § 220.

171 "Margin stock" is defined in Regulation U, Credit By Banks and Persons Other Than Brokers or Dealers for the Purpose of Purchasing or Carrying Margin Stock, 12 C.F.R. § 221.2.

172 If the loan is also secured by collateral other than margin stock, the lender may make a good-faith determination that the other collateral has sufficient good-faith loan value to make up the difference between the regulatory loan value of the margin stock and the amount of the credit extended for a purpose loan. A loan may be deemed to be indirectly secured by margin stock if, after giving effect to the transaction, more than 25% of the assets of the borrower consist of margin stock and the loan agreement contains restrictions on the borrower's ability to sell or pledge that stock. *See* 12 C.F.R. §§ 221 and 222.2.

173 *See* Borrowers of Securities Credit (Regulation X), 12 C.F.R. § 224.

often be very fact-intensive in complicated transactions, the opinion giver may choose to state some of the key facts or assumptions on which the analysis for the particular opinion is based.

Extensions of credit by broker-dealers are covered by Regulation T, not Regulation U. Regulation T is more restrictive and more complex than Regulation U, and, therefore, if a broker-dealer is the lender, a more detailed analysis will be required. Accordingly, the opinion giver may consider including an express assumption that the lender (or subsequent transferee) is not a broker-dealer required to be registered under the 1934 Act.

6. Investment Company Act Issues

The "no violation" opinion is also generally understood not to cover issues under the Investment Company Act of 1940 (as amended, the "1940 Act").[174] Opinion givers are therefore sometimes asked to give separate opinions on these matters. A typical opinion reads as follows:

> The Company is not, and following application of the proceeds of the [loan][securities] will not be, required to register as an "investment company" under the Investment Company Act of 1940.

The Committee believes that this opinion is appropriate only where the transaction presents issues under the 1940 Act and the opinion giver has sufficient familiarity with that Act and regulations issued under it by the SEC.

a. What it means

In financing transactions in which a large percentage of the Company's assets are or will be securities,[175] lenders or purchasers often request an opinion regarding compliance with the 1940 Act.[176] The opinion is limited to determining whether the Company is "required to register" under the 1940 Act. The 1940 Act is enforced primarily by the SEC. If an investment company fails to register under the 1940 Act, the failure can have devastating consequences, since unregistered investment companies that are not exempt from registration may not offer or sell any securities, purchase any securities or engage in any business in interstate commerce.[177]

Investment companies are generally those engaged primarily in the business of investing, reinvesting or trading in securities or owning investment securities having a value exceeding a

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174 Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 to 80a-64.

175 It is important for the opinion giver to bear in mind that items occasionally carried on the Company's financial statements as cash or cash equivalents may qualify as a "security" for purposes of this threshold determination regarding applicability of the 1940 Act.

176 For a thorough discussion of this topic, *see* Tamar Frankel & Ann Taylor Schwing, THE REGULATION OF MONEY MANAGERS: MUTUAL FUNDS AND ADVISERS (2d ed. 2001).

177 *See* 15 U.S.C. § 80a-7(a).

certain percentage of their total assets.[178] However, the 1940 Act contains a number of exemptions from the definition of "investment company" and from the registration requirements applicable to investment companies on which companies often rely. These include, most commonly, the exception for issuers whose outstanding securities (other than short-term paper) are beneficially owned by not more than 100 persons and that are not making, and do not presently propose to make, a public offering of their securities;[179] and issuers that have no more than certain percentages of their assets and net income derived from securities other than government and certain other securities.[180]

Investment companies that are not required to register are not subject to the same limitations on their activities, and therefore an opinion that a company "is not an investment company" is not as meaningful and often is not requested.

In some cases, an opinion giver may be asked for an opinion that the Company is not "controlled" by an "investment company" within the meaning of the 1940 Act. That request, and the corresponding delivery of the opinion by an opinion giver, is only appropriate when the actions of the control party have an impact on the transaction that is sufficient to justify the potential time and resources necessary to (1) analyze who may control the Company (*i.e.*, significant shareholders) and (2) verify that each party who may control the Company is not an investment company.

b. What sort of information lawyers customarily rely upon to deliver this opinion

This opinion often involves complex factual and legal analysis. The opinion giver should consider whether it has sufficient familiarity with the 1940 Act, regulations issued under it by the SEC and related issues. The Company may be asked to represent and/or covenant (in the corresponding section of the Agreement) that the proceeds of the loans or the issuance of securities will not be used in a manner that would cause it to be classified an investment company under the 1940 Act. Opinion givers often request that a financial officer of the Company certify as to the percentage of assets of the Company that consist of, and the percentage of the net income of the Company that is derived from, securities, or the number of its shareholders.

c. Assumptions and exceptions

In most cases, this opinion is given without including any specific assumptions or exceptions, and without disclosing the particular exemption on which the opinion is based. However, the analysis can often be fact intensive and the opinion giver may therefore choose to state some of the key facts or assumptions on which the opinion is based or provide to the recipient applicable financial officer certificates. In rare cases where the issue is not free from

178 *See id.* § 80a-3(a).

179 *See id.* § 80a-3(c)(1).

180 *See* Investment Company Act Rule 3a-1, 17 C.F.R. § 270.3a-1.

doubt, the opinion giver may provide a reasoned opinion explaining the factual and legal analysis for the opinion.

7. All Filings and Consents Obtained in Connection with the Transaction

> All consents, approvals, authorizations or orders of, and filings, registrations and qualifications on the part of the Company with, any United States federal or California regulatory authority or governmental body required for [consummation of the transaction/issuance of securities] have been made or obtained [, except {in the case of the issuance of securities in a non-public transaction}, (a) for the filing of a Form D pursuant to Securities and Exchange Commission Regulation D, (b) for the filing of the notice required to be filed under {California Corporations Code § ___} and (c) {other Blue Sky filings}].

a. What it means

This opinion is intended to give the opinion recipient comfort that the Company has obtained all necessary consents, approvals and orders and has made all filings and obtained all registrations and qualifications required on its part or for it to consummate the transaction. To a considerable extent this opinion overlaps the "no violation" opinion as it relates to applicable laws[181] and the remedies opinion, if given.[182]

b. What sort of information lawyers customarily rely upon to deliver this opinion

A review and understanding of the Agreement is necessary to determine whether any governmental or regulatory consents are necessary to consummate the transaction. To give this opinion, the opinion preparers usually have, or at least consult with someone who has, an understanding of the laws requiring consents that generally apply to the type of transaction involved and, in appropriate cases, conduct legal research or takes other reasonable steps to identify required consents.[183]

c. Assumptions and limitations

The opinion giver may consider including the express limitation, concerning securities filings, in the forepart of the opinion letter, specified in the discussion of the "No Violation — Applicable Law" opinion above (Part V, Section C.4 of this Report).

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181 *See* Part V, Section C.4 of this Report.

182 *Tribar Report* § 6.7 ("[a]s such, [the approvals and filings opinion] overlaps to a considerable extent the remedies and no violation of law opinions.") *See generally* Remedies Report.

183 *See* Appendix 8 ("Application of Customary Practice to the Remedies Opinion") to Remedies Report at Section III(B).

d. Other major opinion reports

TriBar Report: The TriBar Report indicates that the purpose of the opinion is to provide information to the opinion recipient regarding the Company's compliance with legal and regulatory requirements applicable to the Company's participation in the transaction. The TriBar Report states that, as a matter of customary usage, the opinion is understood not to cover local law requirements.[184]

8. Special Note on Absence of Litigation

Opinion givers are often asked to confirm the existence or non-existence of pending or threatened lawsuits against the Company. While many lawyers refer to this as the "no litigation" opinion, it actually is a factual statement as to the state of knowledge of the opinion giver regarding these matters and does not constitute an "opinion." The typical "no litigation" confirmation reads as follows:[185]

> To our knowledge, there are no pending lawsuits or lawsuits threatened in writing[186] against the Company [except as set forth in {Schedule 2 of this opinion} {Section __ of the Agreement} {the certificate of officer of the Company}].

a. What it means

The use of the phrase "to our knowledge" is generally defined in the forepart of the opinion letter by describing the scope of diligence that the opinion giver conducted.[187] As previously noted, the opinion giver should not be a primary source for the facts and the opinion recipient should rely primarily on the Company's representations.[188]

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184 *TriBar Report* § 6.7.

185 Given the size and scope of many clients' businesses, even a "no litigation" confirmation as suggested in the text box may impose unreasonable demands upon the opinion giver. An alternative formulation suggested to the Committee, which the Committee recommends for clients whose businesses are substantial and broad in scope, reads as follows:

> We are not representing the Company in any litigation that is pending, or overtly threatened in writing by a potential claimant, that seeks to enjoin the transaction or challenge the performance by the Company of its obligations under the Agreement.

Note that this alternative formulation does not contain a knowledge qualifier.

186 Of course, as *Ball Hunt* teaches, such a formulation of the confirmation would be inappropriate if the opinion preparers have knowledge of a threatened claim or legal action that is material to the client. *See* Part III, Section B of this Report, and notes 45 and 259.

187 See Part IV, Section D.3 of this Report for a general discussion of "knowledge" considerations, including the importance, especially in larger firms, of qualifying the knowledge definition to a defined group of lawyers of the opinion giver.

188 *See* Part IV, Section B.3 of this Report and Part IV, Section D.3 of this Report.

If an opinion giver is requested to distinguish between "material" and non-material litigation, the opinion giver is placed in the position of evaluating the probable outcome of certain litigation, the range of loss if the client is unsuccessful, and whether that loss would be material to the financial condition or operations of the Company. Absent special circumstances, the Committee believes it would be consistent with opinion practice for an opinion giver to decline a request to deliver this statement, due to the uncertainties of litigation.[189]

An opinion giver ordinarily should not provide an evaluation of the possible outcome of pending or threatened legal proceedings. In instances in which an evaluation of pending litigation is given, it should conform to what the opinion giver would give in response to an audit inquiry request complying with the ABA's Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (1975).[190]

b. What sort of information lawyers customarily rely upon to deliver this opinion

Opinion preparers usually obtain an officers' certificate and poll the lawyers in the firm working on the transaction to determine whether these lawyers know of such litigation or threats of litigation. Some opinion preparers may also run a check of the records of the firm to ascertain whether the firm is acting as counsel of record for the Company in any litigation matter.[191] The definition of "our knowledge" should be stated in the opinion to make clear whose knowledge is covered.

By customary practice, a review of court records is not necessary to provide this factual confirmation.

c. Assumptions and exceptions

Some opinion givers include the following assumption in the forepart of the opinion letter:

> With regard to our statement in paragraph ___ below concerning litigation that is pending or threatened in writing, we have made an inquiry of the lawyers within this firm who have represented the Company in this transaction[,][and] relied upon a certificate executed by an officer of the Company covering such matters[, and checked the records of this firm to ascertain that we are not acting as counsel of record for the Company in any such matter].

189 *See 1989 Report* at 39.

190 *See Accord* § 17.5; *ABA Guidelines* § 4.7.

191 Some opinion givers expand the inquiry to all lawyers working on matters involving the Company. This practice may not be practical, however, for a longstanding client, which may have had many lawyers working on matters for the Company over the course of many years. Without limiting the time frame of the poll, each lawyer who worked on any matter for the client, no matter how trivial or how long ago, would have to be consulted before the confirmation could be given, provided the lawyer was still at the firm.

General matters relating to "knowledge" opinions are addressed in Part IV, Section D.3 of this Report. A specific variant on the type of elaboration that could be used in the context of litigation and used in lieu of the assumption stated above would read as follows:

> Where we provide a statement "to our knowledge" or concerning an item "known to us" or otherwise refer to our knowledge, it is based solely upon (i) an inquiry of lawyers within this firm who have represented the Company in this transaction, (ii) receipt of a certificate executed by an officer of the Company covering such matters, and (iii) such other investigation, if any, that we specifically set forth herein.

d. What the confirmation does not cover

This confirmation does not extend to the merits of any litigation or the records or the roster of any court, tribunal or other forum or authority.

e. Other major opinion reports

TriBar Report: The TriBar Report concludes that the "no litigation" opinion (or "confirmation" because of its factual nature) is designed to elicit information regarding the existence of litigation rather than the merits of a particular litigation matter. Thus, the presence or absence of the phrase "to our knowledge" does not change the meaning of the opinion, which is that the opinion giver does not know that the list of litigation referred to in the opinion letter is incomplete or unreliable. The TriBar Report notes that this confirmation could be eliminated with no real loss to the opinion recipient since it is based largely on information provided by the Company.[192] The Committee concurs.

D. Capital Stock

California lawyers often give opinions on their clients' capital stock, particularly in the context of a transaction involving an issuance or purchase of such capital stock or a merger or acquisition transaction. The more commonly rendered opinions on capital stock are addressed in this Section.

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192 *TriBar Report* § 6.8.

The Accord (¶ 17) provides that the "no litigation" confirmation can be given but it should be limited to litigation that is actually pending or that has been threatened in writing. It further provides that such a confirmation should be based on information generated from a client certificate and a review of the opinion giver's litigation docket. The opinion giver need not review court records and need not canvass "non-participating" lawyers from the firm. The Accord suggests that it should be stated as a "confirmation" rather than an opinion. An evaluation of litigation normally should not be requested. The Committee concurs, although it notes that reviews of an opinion giver's "litigation docket" are not always conducted.

1. Authorized Capital

The California Corporations Code does not include references to "capital stock," "common stock" or "preferred stock." Instead, Corporations Code Section 400 authorizes corporations to issue "one or more classes or series of shares . . . with such rights, preferences, privileges and restrictions as are stated or authorized in its articles." The term "shares" is defined in Corporations Code Section 184 to mean "the units into which the proprietary interests in a corporation are divided in the articles." Corporations Code Section 159 further specifies that "common shares" are "shares which have no preference over any other shares with respect to distribution of assets on liquidation or with respect to payment of dividends." Corporations Code Section 176 specifies that "preferred shares" means "shares other than common shares." Corporations Code Section 402.5 sets forth specific provisions as preferences that may be granted to "preferred shares." For purposes of convenience, the term "capital stock" is used in this Report to refer to the collective set of all securities that a corporation is authorized to issue and that evidence an ownership interest in it.

In that context, a typical opinion as to the authorized capital stock for a California corporation reads as follows:

> The Company's authorized capitalization consists of (a) 15,000,000 common shares, of which 5,000,000 shares are issued and outstanding,[193] and (b) 5,000,000 preferred shares, of which (i) 3,000,000 shares have been designated as Series A Preferred Stock, all of which are issued and outstanding, and (ii) 2,000,000 shares have been designated as Series B Preferred Stock, none of which have been issued.[194]

This form of opinion assumes that the opinion giver is passing upon all of the Company's capital stock. Alternatively, the party requesting the opinion will sometimes request an opinion covering only the status of the shares to be issued in the transaction. If the Company has engaged a third-party transfer agent, the party requesting the opinion may also be satisfied by a certificate of the transfer agent regarding the number of outstanding shares.

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193 Since January 1, 1977, with the enactment of the GCL, when a California corporation reacquires its own shares, they no longer become treasury shares. Instead, the shares are automatically restored to the status of authorized but unissued shares, unless the articles prohibit their reissuance. CAL. CORP. CODE § 510(a). Shares that were treasury shares on December 31, 1976, remain treasury shares unless retired. With respect to corporations formed on or after January 1, 1977, therefore, it may be superfluous to refer to shares as being "issued *and* outstanding" since all outstanding shares must therefore, have been issued.

194 *See* Part IV, Section B.1 of this Report. Although an opinion as to the validity of the issuance of all outstanding capital stock is not cost-effective in most situations, such an opinion would read as follows:

> The issued and outstanding common shares and preferred shares of the Company have been duly authorized and validly issued and are fully paid and nonassessable.

See the discussion of this opinion in Section D.6 below, "Outstanding Equity Securities."

The Committee notes that a lawyer's opinion on the number of outstanding shares is not entirely a legal opinion. Independent auditors report on a corporation's balance sheet, which includes disclosure of the number of shares of each class outstanding on the date of the balance sheet. When stock opinions are rendered, sound arguments suggest that counterparties in the subject transaction should be satisfied with a certificate provided by an officer of the Company or its transfer agent on this point. An opinion on the number of shares outstanding would be based solely on an examination of the Company's stock book or on a certificate from the Company's transfer agent. The opinion giver has no duty to inquire further. A transfer agent is a person whose function is to monitor, and maintain records regarding, the issuance and transfer of securities and has as one of its purposes preventing unauthorized issuances of shares.[195]

2. Duly Authorized

The "duly authorized" opinion is typically combined with the "validly issued" and "fully paid and nonassessable" opinions, and reads as follows:

> The shares have been duly authorized and validly issued and are fully paid and nonassessable.

The parts of this opinion are closely interrelated and are addressed in this and in the following two subsections.

a. What the duly authorized opinion means

The "duly authorized" opinion means that the Company had the corporate power under its articles and bylaws to issue the shares of capital stock as of the time they were issued and that the Company took all necessary corporate action (including board approval and, if necessary, shareholder approval) to authorize the issuance of the shares. As used in a capitalization opinion, this opinion also indicates that the Company had sufficient authorized shares of each class to cover all outstanding shares as of the time of the issuance of the shares.

As the TriBar Report notes, the "duly authorized" opinion also covers whether the applicable state corporation law permits shares having the characteristics of the shares of capital stock that are the subject of the opinion.[196] Accordingly, the "duly authorized" opinion should not be given as to capital stock if the terms of that stock are prohibited by the GCL.[197]

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195 *See* 1934 Act, § 3(a)(25), 15 U.S.C. § 78c(a)(25).

196 *TriBar Report* § 6.2.1. The TriBar Report also notes, in its discussion of the "validly issued" opinion, that that opinion likewise could not be given if the share issuance violated "applicable state corporation law . . ." *TriBar Report* § 6.2.2.

197 *See, e.g.,* CAL. CORP. CODE § 402(c) (prohibiting the issuance of redeemable common shares other than as permitted by that subdivision).

b. What sort of information lawyers customarily rely upon to deliver this opinion

California corporations have the statutory power under Corporations Code Section 207 to issue their own shares.[198] However, this power is subject to:

- limitations contained in the articles;
- compliance with other provisions of the GCL; and
- compliance with any other applicable laws (not including, for this purpose, securities laws).

California law requires that the articles specify the total number of shares that the corporation is authorized to issue.[199] It is generally recognized that the corporation may not issue shares in excess of the amounts authorized.[200] In rendering this opinion, the authorized number of shares of capital stock can be verified by an examination of the articles, as amended, certified by the Secretary of State.[201] When the Company has two or more classes or series of capital stock, the opinion giver must determine whether a sufficient number of shares was authorized on a class-by-class or series-by-series basis prior to rendering the opinion.

In rendering this opinion, the number of outstanding shares is customarily ascertained solely from a review of the stock record book of the Company[202] or from a certificate of its transfer agent (if the Company has one). Lost, destroyed, stolen or wrongfully-taken share certificates can occasionally create a problem with respect to an opinion concerning the number of outstanding shares. In such cases, the Company or its transfer agent will ordinarily require an indemnity bond before issuing a replacement certificate.[203] If a replacement certificate is issued and a "protected purchaser"[204] of the original certificate presents it for transfer, the Company

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198 CAL. CORP. CODE § 207(d).

199 *Id.* § 202(d). If the corporation is authorized to issue more than one class of shares, or if any class of shares is to have two or more series, the articles must specify (among other things) the total number of shares of each class and the total number shares of each series that the corporation is authorized to issue or that the board of directors is authorized to fix the number of shares of any such series. *Id.* § 202(e).

200 *See* U.C.C. § 8-210 cmt.1. Where the shareholders previously approved an issuance of options or securities convertible into shares of the corporation's capital stock, however, Corporations Code Section 405 provides that the board of directors of the issuer may, without further shareholder approval, amend the articles to effect an increase in authorized shares to accommodate the exercise or conversion rights of the holders of such options or convertible securities. CAL. CORP. CODE § 405(b).

201 As noted previously, under California law the term "articles" includes the articles of incorporation, amendments thereto, amended articles, restated articles, certificates of incorporation and certificates of determination. *Id.* § 154.

202 Also referred to as a "stock ledger" or a "stock transfer book."

203 *See* CAL. COM. CODE § 8405; CAL. CORP. CODE § 419 (setting forth the responsibility of an issuer in the case of lost, destroyed or wrongfully taken security certificates).

204 A "protected purchaser" is a purchaser who (i) gives value, (ii) does not have notice of any adverse claim to the security; and (iii) obtains control of the security. CAL. COM. CODE § 8303. All three elements must exist

(footnote continued on next page)

must register the original certificate *unless* registration would result in an over-issue. This could result in a larger number of outstanding shares than is authorized. However, the Company is not required to issue more shares than it has the power to issue.[205] If previously issued shares have been cancelled, the opinion giver must determine whether, under the articles, the cancellation resulted in a reduction in the number of authorized shares.[206]

c. What the opinion does not cover

The "duly authorized" opinion does not address whether the authorization of the shares complies with agreements by which the Company is bound or complies with any law other than the GCL. Compliance with other state and federal laws relating to the issuance of capital stock should be addressed, if at all, in a separate legal opinion delivered to the recipient.

The "duly authorized" opinion is also generally understood not to address the adequacy of any proxy solicitation or other disclosure document or compliance with the proxy rules of the SEC, since the opinion is understood to relate only to the aspects of the issuance governed by the GCL. However, opinion givers should be mindful of the need to avoid giving misleading opinions.[207]

In rendering the "duly authorized" opinion, opinion givers assume compliance by the Company's directors with their fiduciary duties in determining the amount or type of consideration paid for the shares. Some California lawyers expressly qualify their "duly authorized" opinions by stating that they do not address compliance with fiduciary duties. That qualification is not necessary because it is generally understood by customary usage that the directors have fulfilled their fiduciary duties. However, there may be circumstances, such as in reorganizations, where a statement of the assumption to an opinion on the due authorization of shares is appropriate.

3. Validly Issued

a. What it means

Although the GCL provides for the "issuance" of shares, it does not define that term.[208] The "validly issued" opinion confirms that issuance of the shares complied with the requirements set forth in the articles and bylaws, including any preemptive rights contained in the articles, and

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(footnote continued from previous page)

at one time for a purchaser to be a "protected purchaser." Comment 2. "Purchaser" is defined in CAL. COM. CODE § 1201; "adverse claim" is defined in CAL. COM. CODE § 8102(a)(1); and "control" is defined in CAL. COM. CODE § 106.

205 CAL. COM. CODE § 8405(b). In such cases, the corporation's liability is governed by CAL. COM. CODE § 8210.

206 *See* CAL. CORP. CODE § 510(b).

207 In this regard, federal courts have broad equitable powers to remedy violations of the 1934 Act and the rules and regulations of the SEC. *See, e.g.*, Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970).

208 The Committee notes that the issuance of shares is generally understood to refer to the act or contract by which a person becomes a shareholder of a corporation.

with the requirements of the GCL. In addition, the opinion confirms that the shares were issued for proper and sufficient consideration and are evidenced by appropriate certificates that have been properly executed and delivered, or, in the case of uncertificated shares, that the Company has otherwise taken sufficient steps to grant full shareholder status to the purchaser of the shares. The "validly issued" opinion cannot properly be given if the shares were issued without proper board or shareholder approval, in violation of any shareholders' preemptive rights set forth in the articles, or in excess of the number of authorized shares.[209] While this Report maintains a distinction between the "due authorization" and "validly issued" opinions, an opinion giver should not render a "validly issued" opinion if the opinion giver could not also give the "duly authorized" opinion (or appropriately rely on an assumption or an opinion of other counsel as to due authorization), whether or not requested to do so.

b. What sort of information lawyers customarily rely upon to deliver this opinion

The opinion giver must consider whether the Company is required to receive consideration for the issuance of shares.[210] If shares are required to be issued for consideration, then the validity of the issuance will depend upon whether the type of consideration received is permitted by applicable law.[211] Opinion givers often address issues of consideration when rendering the "validly issued" opinion by phrasing the opinion to state that "when the shares are issued in accordance with the Agreement," they will be validly issued, fully paid and nonassessible.

Shareholders of California corporations often grant the board of directors broad authority to authorize the issuance of new shares of capital stock using "blank check preferred" stock. In other cases, the board of directors will delegate to a committee of the board the authority to approve the issuance of shares (*e.g.*, delegation to a compensation committee authorized to grant options to purchase shares pursuant to a stock option plan). For shares issued pursuant to such delegated authority, opinion givers confirm that the delegation and issuance were permissible under the articles and bylaws and the GCL.

The opinion giver should also be alert to any instance in which shares have been or will be issued for consideration other than cash.[212] Corporations Code Section 409(e) requires that the Company's board of directors "state by resolution its determination of the fair value to the corporation in monetary terms" of any such consideration.[213] The GCL does not, however, require any specific amount of consideration for the issuance of shares. Thus, the failure of the

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209 The articles may include a provision requiring the approval of the shareholders or the approval of the outstanding shares for any corporate action. CAL. CORP. CODE § 204(a)(9). Additionally, shares may be issued in transactions, such as mergers, that require shareholder approval.

210 Shares may be issued without the receipt of consideration in the case of, among other things, stock dividends or splits. *Id.* § 409(a)(2).

211 *See id.* § 409 (defining the various types of legal consideration for the issuance of shares by California corporations).

212 CAL. CORP. CODE § 409(e).

213 *Id.*

board of directors to make that determination should not affect the validity of the issuance, but rather the fulfillment of the directors' fiduciary duty.[214]

There is no substantive difference between an opinion that shares are "validly issued" and an opinion that shares are "legally issued." This question arises in the context of an Exhibit 5 opinion included as part of a registration statement under the 1933 Act. Schedule A (Part 29) of the 1933 Act and Item 601(b)(5)(i) of Regulation S-K under the 1933 Act require the issuer to file an opinion of counsel as to the legality of the securities to be issued.[215] Item 601(b)(5)(i) of Regulation S-K states that "the opinion [the Exhibit 5 opinion] must indicate whether the securities will, when sold, be legally issued, fully paid and non-assessable . . . ."

Notwithstanding the foregoing express requirement, many such opinions state that the securities are "validly issued" in lieu of stating that they are "legally issued." As noted by the Task Force on Securities Law Opinions of the ABA Section of Business Law, in its 2004 *Report on Legal Opinions in SEC Filings*, "in Exhibit 5 opinions, many lawyers use the more customary formulation that the securities have been 'duly authorized and, [when sold in accordance with the provisions of the applicable purchase agreement], will be validly issued, fully paid and nonassessable.'"[216]

c. What the opinion does not cover

As previously noted, an opinion that shares have been "validly issued" cannot be given if their issuance violates preemptive rights set forth in the Company's articles.[217] However, the "valid issuance" opinion should not be understood to address whether the issuance resulted in a breach or default under any contract to which the Company is a party, such as a shareholders agreement.[218] Even in the event of such a breach or default, the opinion giver may still render an unqualified opinion regarding the valid issuance of shares. A recipient desiring an opinion on whether shares were, or will be, issued in violation of contractual rights should request an opinion specifically addressing that question.

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214 The Committee recommends, however, that any such failure be corrected or the omission noted in the opinion.

See also Crowder v. Electro-Kinetics Corp., 228 Ga. 610, 187 S.E.2d 249 (1972). In *Crowder*, the Georgia Supreme Court, interpreting a statute very similar to Section 409(e) of the GCL, held that the failure of a board to make a determination by resolution of the value of consideration received for the issuance of shares of stock does *not* make the issuance null and void and subject to cancellation.

215 Regulation S-K, 17 C.F.R. § 601(b)(5)(i).

216 *SEC Filings Report*, 59 BUS. LAW. at 1507 (footnote omitted).

217 Unless otherwise provided in the articles, the board may issue shares, options or securities having conversion or option rights without first offering them to the shareholders of any class. CAL. CORP. CODE § 406. The GCL permits the inclusion in the articles of a provision granting preemptive rights. *Id.* § 204(a)(2). As a result, the only diligence necessary to give this opinion is an examination of the articles to confirm that they do not contain a preemptive rights provision.

218 See the discussion of the "no violation" opinion in relation to Material Agreements, Part V, Section C.2 of this Report.

Furthermore, opinions on the valid issuance of the Company's capital stock do not address issues related to the fiduciary duties of directors: that is, where the board action authorizing the issuance is challenged as a violation of the board's fiduciary duties.[219] For example, the sale of shares to insiders in a "down round" financing might be challenged as the product of an improper corporate decision-making process or otherwise as unfair to the Company or its shareholders. Issues related to whether the Company's board of directors complied with its fiduciary duties hinge on questions of fact that generally make the subject unsuitable for coverage in a legal opinion. Opining on fact-intensive matters necessarily means that the opinion giver will have to rely upon elaborate assumptions that substantially impair the value of the opinion and can be very costly.[220]

Finally, a "valid issuance" opinion on a California corporation is based on compliance with the GCL and does not address any other laws of the State of California or any other jurisdiction. Thus, the opinion does not address compliance with securities laws.[221] Securities law issues are properly addressed in separate opinions as discussed elsewhere in this Report.[222]

4. Fully Paid and Nonassessable

a. What it means

Shares are "fully paid" and "nonassessable" if the Company has received the consideration for the shares specified by the board. In support of the "fully paid" opinion, opinion preparers will typically confirm (i) that the consideration paid for the shares was in the amount and form specified by the board of directors when it authorized the issuance, and (ii) that the consideration specified was received prior to or contemporaneously with the issuance of the shares. Certificates of the Company's chief financial officer or other qualified officer can be used to establish the type, amount and timing of consideration received for the shares.[223]

If the Company has received the consideration for the shares specified by the board, then the Company cannot require additional payment beyond the consideration agreed to be paid for the shares. Moreover, shares are not "assessable" unless the articles expressly confer that

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219 *See* Part V, Section D.3.a of this Report. The valid issuance opinion does not, therefore, address whether the issuance of shares violates the shareholders' so-called "quasi-preemptive" rights. For background, see 1 BALLANTINE & STERLING § 127.03[8][b]; 1 MARSH'S CALIFORNIA CORPORATION LAW § 7.12.

220 In this context, counsel should be sensitive to the liability an opinion giver may have for an opinion that constitutes a fraudulent misrepresentation, *see* Part III, Section B of this Report, and the potential liability apart from the opinion letter as a result of involvement in a transaction under the anti-fraud rules of federal or state securities laws. *See TriBar Report* § 1.4 ("non-opinion liability").

221 *See* Part III, Section B of this Report.

222 *See* Part V, Section E of this Report and Part VI, Section B.2 of this Report.

223 The Company's statement of shareholders' equity will include the dollar amount of the consideration received for the issuance of shares. For a discussion of the opinion giver's responsibility for the factual basis of this and other opinions, see Part IV, Section D.3 of this Report.

Under the GCL a corporation may issue "partly paid" shares. *See* CAL. CORP. CODE § 409(d).

authority on the board of directors or unless otherwise provided by a statute separate from the GCL.[224]

The assessability of shares differs from the right to collect the consideration agreed to be paid by a purchaser for the shares. Assessability means the right of the Company pursuant to provisions of the articles to require shareholders to make additional capital contributions to the Company after the initial issuance of, and payment for, the shares.

b. What sort of information lawyers customarily rely upon to deliver this opinion

To confirm "full payment" an opinion giver generally obtains an officers' certificate to the effect that the Company has received the consideration called for by the directors in approving the issuance of the shares. There may, however, be some uncertainty with respect to the "fully paid" status of shares issued by certain California corporations at less than their par value. Under Corporations Code Section 110 in effect prior to January 1, 1977, the value of consideration received by a corporation for the issuance of shares having par value was required to be at least equal to the par value, with exceptions that are not applicable to this discussion. The GCL, which became effective on that date as part of the Corporations Code, has eliminated any reference to par value (except where required by other statutes or regulations).[225] Corporations existing prior to the effectiveness of the GCL are not required to amend their articles to eliminate par value, and the effect of the issuance of par value shares by these corporations for a lesser value is not clear if they have not so amended their articles.

The GCL has also eliminated uncertainties with respect to the "fully paid" status of stock dividends. Prior to 1977, the Corporations Code specified that dividends payable in shares of a corporation (stock dividends) could be declared only out of earned surplus, paid-in surplus or surplus arising from reduction of stated capital. In addition, the accounting treatment of the respective accounts of a corporation was specified by former Section 1506. If the required transfer between accounts was not made, a question also arose as to whether sufficient consideration had been given for the shares issued pursuant to the stock dividend.

The GCL changed this treatment by subjecting "distributions to shareholders" to the provisions of its Chapter 5.[226] Corporations Code Section 166 expressly excludes stock dividends from the definition of "distribution to shareholders."[227] Corporations Code Section 114 requires that generally accepted accounting principles be used in the preparation and

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224 CAL. CORP. CODE § 423(a). The Committee is unaware of any California statute in effect on the date of this Report other than the GCL that grants powers to assess the shares of capital stock of California corporations. Because an opinion addressing whether shares are "fully paid and nonassessable" addresses only the GCL, the effect of other statutes, unless they are expressly covered, are not relevant to this opinion.

225 CAL. CORP. CODE § 205.

226 *Id.* §§ 500-511. Corporations Code Section 188 defines a stock split as a "pro rata division, otherwise than by a share dividend, of all the outstanding shares." *Id.* § 188. Thus, stock splits are not subject to the provisions of Chapter 5 of the GCL.

227 *Id.* § 166.

determination of financial statements and accounting items, and those principles may require transfers from retained earnings.[228] Nevertheless, those principles do not affect the legality or validity of the issuance, and the absence of retained earnings or the failure to make transfers in accordance with generally accepted accounting principles no longer raises the possibility that shares issued as stock dividends are not fully paid.[229]

c. Assumptions and exceptions

In some transactions, the shares are to be issued, and the consideration received, after the date of the opinion. In those instances, the "fully paid and non-assessable" opinion may properly be qualified to indicate that the shares will not be "fully paid" until the consideration required by the underlying transaction documents has been received by the issuer.[230]

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228 *Id*. § 114. In the aftermath of several highly visible financial reporting scandals in 2001 and following in the path of the Sarbanes-Oxley Act of 2002, the Financial Accounting Standards Board ("FASB") initiated several modifications to "generally accepted accounting principles" affecting the consolidation, for financial reporting purposes, of otherwise separate entities. Recently, the FASB has modified its standards for reporting the cost of stock options. These developments serve as a reminder that "generally accepted accounting principles" are not fixed and can have an impact on law and on opinions rendered with respect to corporate activities and transactions.

229 It should be noted that Division 8 of the California Uniform Commercial Code previously provided a legal framework to govern the rights, obligations, and relationships of issuers and others only as to shares evidenced by physical stock certificates. Effective January 1, 1985, the Division was amended also to cover shares for which the issuance, recordation and transfer are accomplished exclusively by registration upon books maintained for the purpose of recording transfers by or on behalf of the issuer and that do not involve the issuance or subsequent transfer of physical certificates (i.e., "uncertificated securities"). At the same time, Corporations Code Section 416 was amended to permit both publicly held and private corporations to adopt a system of issuance, recordation, and transfer of shares using uncertificated securities. This system is normally implemented through an electronic book-entry transfer facility and is utilized primarily by corporations whose securities are publicly traded in national markets. Division 8 was amended again, effective January 1, 1997. This version also has provisions covering uncertificated securities.

The enactment of statutory changes permitting the issuance of uncertificated shares has not altered the legal requirements for authorizing and issuing securities. Shares still must be authorized for issuance in the articles and by proper action by the Company's board of directors, and still must be issued for valid consideration. Accordingly, the lawyer who is requested to provide an opinion with respect to the due authorization, valid issuance and "fully paid" status of uncertificated securities will be required to go through the same analysis as for securities evidenced by physical certificates.

An essential difference in the diligence that must be conducted by the opinion giver concerning the "issuance" of uncertificated securities is that the review of the stock records of the Company will often involve a review of computerized records held by the Company's transfer agent and/or receipt of a certificate from the transfer agent certifying to the issuance of the uncertificated shares to the purchaser.

230 A typical form for this qualification reads as follows:

> Upon receipt of the consideration required by the Agreement, the shares will be fully paid and non-assessable.

d. What the opinion does not cover

The "fully paid and non-assessable" opinion only addresses those matters specifically described above. It does not address the possibility that shareholders will be subject to other liabilities in connection with their ownership of the shares. Other liabilities could include those imposed upon them as controlling shareholders, for the receipt of unlawful dividends, or as a result of piercing the corporate veil.

5. Reservation of Shares

a. What it means

This opinion confirms that the Company has taken action necessary to reserve the number of shares specified for future issuance upon conversion of convertible securities or the exercise of options or warrants. The GCL does not, however, provide any legal effect to the "reservation" of shares. Accordingly, the opinion is almost entirely factual (*i.e.*, establishing the existence of resolutions "reserving" shares for future issuance). Because reservations have no legal effect under the GCL, lawyers generally resist giving this opinion as it is potentially misleading and opinion recipients ordinarily are satisfied by a representation by the Company or by an officer's certificate on this point. An alternative is for the opinion to address only the question of whether the board of directors of the Company has duly adopted a resolution "reserving" such shares and whether that resolution remains in force.

b. What sort of information lawyers customarily rely upon to deliver this opinion

An opinion giver typically examines the Company's minute book to confirm that appropriate resolutions have been adopted by its board of directors, and that those resolutions have not been subsequently amended, modified or repealed. This is usually confirmed by an officers' certificate certifying to the adoption and continued effectiveness of the relevant resolutions.[231]

c. Assumptions and exceptions

An opinion giver that delivers this opinion may in appropriate situations qualify its opinion to make clear that anti-dilution rights applicable to convertible securities, options or warrants could result in the reservation of a number of shares for issuance upon conversion or exercise that exceeds the number of shares authorized by the Company. Under Division 8 of the California Uniform Commercial Code, the holder of a convertible security, option, or warrant cannot compel an overissue, notwithstanding the board's action "reserving" shares.[232]

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231 *See* CAL. CORP. CODE § 314.

232 CAL. COM. CODE § 8210.

d. What the opinion does not cover

A "reservation of shares" opinion does not address the power of the Company to subsequently authorize by action of its board of directors the issuance for some other corporate purpose of shares previously reserved for issuance upon the conversion of convertible securities or the exercise of options or warrants. Thus, purchasers of securities with conversion or exercise rights need to address the issue in other ways, for example through use of a covenant of the Company to maintain at all times a sufficient number of authorized but unissued shares to allow for the conversion or exercise.

6. Outstanding Equity Securities

Underwriters of a Company's initial public offering, and stock exchanges in connection with the initial listing of a Company's equity securities, will typically request an opinion that not only the shares to be issued in the proposed transaction but also all outstanding equity securities of the Company have been duly authorized and validly issued and are fully paid and nonassessable. These opinions, particularly for a client that has been in existence for a long time, require extensive factual inquiry and heavy reliance upon officers' certificates, and therefore consideration must be given to whether the benefit is justified in terms of the cost and time involved.[233]

E. Selected Blue Sky and Federal Securities Law Issues

1. General Considerations

The "due authorization" and "valid issuance" opinions do not address compliance with disclosure, registration, qualification and other requirements of state or federal securities laws.[234] Those requirements raise complex and fact-intensive issues and, when addressed at all, customarily are addressed in a separate paragraph or letter containing carefully qualified terms.

The context in which securities law opinions are given can differ from those of other third-party closing opinions. The securities laws themselves are intended to protect investors and provide them with an array of remedies that may be unavailable in other contexts. Thus, the opinion giver of a securities law opinion may be subject to claims and liability as a primary violator or as an aider and abettor (in SEC disciplinary or enforcement actions) under federal securities laws.[235] Opinion givers in California may be requested to render opinions with respect

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233 *See TriBar Report* § 6.2.5; *ABA Guidelines* § 4.2.

234 *See* Part IV, Section D of this Report.

235 *See, e.g.,* In re Enron Corp. Sec., Derivative & ERISA Litig., 235 F. Supp. 2d 549, 704-06 (S.D. Tex. 2002) (upholding a claim stated under Section 10(b) of the 1934 Act against a law firm that, *inter alia*, delivered "true sale" opinions allegedly essential to effect a client's fraudulent transaction while allegedly knowing of the client's ongoing illicit and fraudulent conduct and frequently making public statements about the client's business and financial condition.). The lesson of the Enron litigation is that care must be given when rendering opinions that facilitate securities transactions, not just the risk of rendering securities law opinions *per se*. There is no aiding and abetting liability for violations of Rule 10b-5 under the 1934 Act. *See* Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994). However, California has specific prohibitions and penalties pertaining to securities transactions in the CSL that may be asserted

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to the CSL, the 1933 Act and the 1934 Act. Other portions of this Report address issues that arise for opinion givers with respect to certain other federal securities laws[236] and with respect to other state securities laws.[237] This Report is not intended to be a guide to the substantive requirements of federal and state law exemptions. For a discussion of the substantive requirements under the CSL and certain matters of the CSL related to federal securities laws, see the Committee's Guide to California Securities Law Practice, 2003 edition.[238]

The Committee notes that, because the purpose of the federal securities laws is to protect investors, the SEC has taken the position that an opinion giver fails to meet applicable standards of conduct if it fails to conduct an inquiry into the underlying facts.[239] Moreover, courts have

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against lawyers. Corporations Code Section 25504 imposes joint and several liability on agents who materially aid persons liable for misrepresentations made in connection with an offer or sale of securities, unless the agents had no knowledge of or reasonable grounds to believe in the existence of the facts by reason of which the liability is alleged to exist. CAL. CORP. CODE § 25504. Section 25504.1 imposes joint and several liability on any person who materially assists in a violation of the qualification or antifraud provisions of the Corporations Code with the intent to deceive or defraud. *Id*. § 25504.1; Orloff v. Allman, 819 F.2d 904, 907 (9th Cir. 1987) (limiting liability for aiding and abetting a state securities violation limited to cases in which the defendant had an "intent to deceive or defraud").

236 *See* Part V, Section C.6 of this Report.

237 *See* Part VI, Section B.2 of this Report.

238 The version of the Guide current at publication of this Report is identified as the "June 2004 Printing."

239 *See, e.g.*, Attorney's Conduct in Issuing an Opinion Letter, Exchange Act Release No. 34-17831, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,874 (June 1, 1981). In the SEC's report under Section 21(a) of the 1934 Act, the SEC declined to institute an enforcement proceeding against a lawyer who rendered an opinion as counsel for the underwriter in a sale of industrial revenue bonds. Although the opinion letter stated that the lawyer had not independently checked or verified most of the material statements in the offering circular, the lawyer (who knew that the issuer had been in operation for a number of years) rendered his opinion letter without questioning the omission of prior years' financial statements, reviewing any documents about the financial status of the issuer, or making inquiry as to the results of operations for prior years. Citing with approval the American Bar Association's Committee on Ethics and Professional Responsibility Formal Opinion 335, *see* note 247, the SEC stated that when the facts obtained from the client appear incomplete or inconsistent with facts known to the lawyer, and the lawyer is not satisfied as to all the relevant facts, the lawyer should refuse to render an opinion:

> The smooth functioning of the securities markets will be subject to serious disruption if the public cannot safely rely on the expertise proffered by lawyers rendering their opinions. Unless lawyers carefully and competently ascertain the relevant facts, and make a reasonable inquiry of their clients to obtain facts not within their personal knowledge, their opinions may facilitate fraudulent transactions in securities. This is so particularly as the investing public looks to the lawyer's opinion as a safeguard against violations of the federal securities laws.

The Committee is unaware of any judicial decision or other SEC enforcement action citing this SEC release. The SEC's position appears consistent with the proposition that counsel cannot rely on factual information from its client, or base its opinions on "assumptions," that it recognizes as untrue. *See* Kline v. First Western Government Securities, Inc., 24 F.3d 480, 487 (3d Cir. 1994) ("[W]hen a law firm knows or has good reason to know that the factual description of a transaction provided by another is materially different from the actual transaction, it cannot escape liability simply by including in an opinion letter a statement that its opinion is based on provided facts.").

held that the mere presence of disclaimers of investigation by the opinion giver will not eliminate triable issues of fact concerning whether the opinion is misleading or whether the recipient's reliance was not justified in the circumstances.[240]

For opinions rendered in securities transactions, the opinion giver thus must consider carefully the unique liability context in which such opinions are given and take care that they are not rendered in circumstances that are misleading even though the opinions may be technically correct. Lawyers contemplating serving as an opinion giver in federal securities law matters should also familiarize themselves with rules adopted by the SEC in the aftermath of several highly visible financial reporting scandals in 2001 and following adoption of the Sarbanes-Oxley Act of 2002.[241]

This section addresses securities law opinions in private offerings of securities. It does not address other legal opinions issued by securities counsel such as opinions to underwriters in registered public offerings of securities and opinions that are required by the SEC and the national securities exchanges.[242]

2. Exemption from Federal Registration or State Law Qualification — Private Offerings

> Based in part upon the representations made by the Company and the purchasers in the Agreement, the offer[,] [and] sale [and issuance] of the [Shares] in conformity with the terms of the Agreement and the issuance of the common stock, if any, to be issued upon conversion thereof, do not require registration under Section 5 of the Securities Act of 1933, as amended [, or qualification under the California Corporate Securities Law of 1968, as amended].[243]

240 *See e.g., Kline*, note 239.

241 *See* 17 CFR Part 205, "Implementation of Standards of Professional Conduct for Attorneys."

242 *See* Part V, Section C.8; Part V, Section D.1; Part V, Section D.2; and Part VII, Section B of this Report. *See also* Section E.2.b.3 of this Part V and *SEC Filings Report*.

243 This opinion addresses the issuance of preferred shares that are convertible into shares of common stock. Under the CSL, the offer or sale of convertible securities includes the offer of the shares issuable upon conversion of the convertible securities; the conversion of the preferred shares (without the payment of additional consideration) does not constitute an offer or sale of the common shares under the CSL. CAL. CORP. CODE § 25017(e). Under the 1933 Act, issuance of convertible securities also includes the offer of the shares of common stock into which the securities are convertible; the issuance of shares of common stock issuable upon conversion of preferred shares (without the payment of additional consideration) is exempt from registration under Section 3(a)(9) of the 1933 Act because it constitutes a "security exchange by the issuer with its existing securityholders exclusively . . . ." *See* Charles J. Johnson, Jr. & Joseph McLaughlin, CORPORATE FINANCE AND THE SECURITIES LAWS 875-78 (3d ed. 2004).

a. What it means

Issuers and purchasers of unregistered securities will at times request an opinion on the need to comply with the registration requirements of Section 5 under the 1933 Act or the qualification requirements of the CSL.[244]

Many opinion givers rely on the "safe harbors" provided by Regulation D under the 1933 Act for compliance with Section 4(2) or Section 3(b) of the 1933 Act.[245] The particular statutory exemption relied upon is not customarily stated in the opinion. If Regulation D is the basis for the federal exemption opinion, neither that reliance nor the particular rule relied upon is customarily stated in the opinion.[246]

b. What sort of information lawyers customarily rely upon to deliver this opinion

As with any legal opinion, the opinion preparer must competently and diligently consider what facts are relevant to the opinion. With regard to each factual matter supporting a securities law opinion, the opinion preparers must inquire of the Company and possibly others (*e.g.*, the placement agent) as to the relevant facts and both receive and assess the answers. Further inquiry is involved if the facts are incomplete in any material respect, are suspect or inconsistent or otherwise open to question. The extent of this inquiry will depend in each case upon the circumstances. For example, the inquiry would be less intensive when the opinion giver has had an ongoing relationship with the Company than in instances in which the Company has recently engaged the opinion giver. Similarly, the inquiry might be less intensive in instances in which the opinion preparer's inquiries are answered fully than in instances in which there appears to be a reluctance to disclose information. If the opinion preparers conclude that further inquiry would not provide them sufficient confidence as to all the relevant facts, they should refuse to give the opinion. If facts do not appear to be incomplete, suspect or otherwise open to question, the opinion giver may properly assume that the facts as related to it by the Company and confirmed by reviewing appropriate documents are accurate.[247]

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244 Section 5 of the 1933 Act prohibits the use of the mails or facilities of interstate commerce to sell a security unless a registration statement is in effect covering such security or an exemption from registration is available. 15 U.S.C. § 77e. Exemptions from registration include Section 4(2) of the 1933 Act, for transactions by an issuer not involving a public offering, and Section 3(b) of the 1933 Act, relating to small offerings. 15 U.S.C. §§ 77d, 77c.

245 *See* 17 C.F.R. §§ 230.501-230.508 prelim. n.3. Rule 506 provides a safe harbor for offerings exempt from registration pursuant to Section 4(2). 17 C.F.R. § 230.506. Rules 505 and 504 provide registration exemptions for offerings pursuant to Section 3(b) of the 1933 Act. 15 U.S.C. § 77r; 17 C.F.R. §§ 230.505, 230.504.

246 Section 18(b)(4)(D) of the 1933 Act preempts state regulation of transactions that are exempt from registration pursuant to Rule 506. 15 U.S.C. § 77r. Also, exemptions under certain state securities laws, such as the "Uniform Limited Offering Exemption," are predicated upon compliance with a specific 1933 Act exemption.

247 *See* A.B.A. Comm. on Ethics and Prof'l Responsibility, Formal Opinion 335, 60 A.B.A.J. 488 (1974) [hereinafter *ABA Formal Opinion 335*]. ABA Formal Opinion 335 sets forth guidelines for opinions written as a basis for transactions involving sales of unregistered securities; it does not address opinions written in

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The Committee notes that the SEC has, for reasons of public policy, stated that the responsibilities of opinion givers in assessing the factual bases for opinions that facilitate unregistered sales of securities are more demanding than in negotiated transactions between institutional or sophisticated parties.[248] However, the Committee believes that the function of lawyers in securities transactions should be no different than that in other transactions. Thus, a legal opinion should not be viewed as a guaranty of the factual accuracy of representations made by the Company either in support of the opinion or directly to the opinion recipients.[249] The Committee notes that, despite their legal training, lawyers may not have the background or expertise to evaluate a variety of factual matters such as financial, accounting, technical, scientific, statistical or engineering information. Thus, the Committee believes that the proper function of the opinion is to provide the opinion giver's professional legal judgment based on the facts that have been represented to it -- not to guarantee the accuracy of those facts.[250]

i. Information Concerning the Purchasers

Reliance on the purchaser's representations regarding its financial status may be sufficient, for example, in a negotiated private placement of securities to a limited number of institutions or other "accredited" investors.[251] In other situations (*e.g.*, in non-institutional

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connection with securities registrations. The essence of ABA Formal Opinion 335 is that a lawyer should make adequate preparation, including inquiry into the relevant facts, consistent with the guidelines. While the lawyer should not accept as true that which he or she should not reasonably believe to be true, the lawyer does not have the responsibility to "audit" the affairs of his or her client or to assume, without reasonable cause, that a client's statement of the facts cannot be relied upon. ABA Formal Opinion 335 has been cited with favor by the SEC. *See* Exchange Act Release No. 34-17831, notes 4 and 5.

248 In 1962, and again in 1971, the SEC addressed the standards of conduct expected of registered broker-dealers in connection with the distribution to the public of substantial blocks of unregistered securities. At that time, the SEC stated that, "if an attorney furnishes an opinion based solely upon hypothetical facts which he has made no effort to verify, and if he knows that his opinion will be relied upon as the basis for a substantial distribution of unregistered securities, a serious question arises as to the propriety of his professional conduct" (*citing* United States v. Francis Peter Crosby, 294 F.2d 928 (2d Cir. 1961), the SEC noted that the court appeared to have regarded the giving of such opinions as significant evidence supporting a jury finding that a lawyer was guilty as a criminal co-conspirator). See Distribution by Broker-Dealers of Unregistered Securities, Securities Act Release No. 33-4445 (February 2, 1962); Sales of Unregistered Securities by Broker-Dealers, Securities Act Release No. 33-5168 (July 7, 1971). The Committee is unaware of any judicial decision citing Release Nos. 33-4445 or 33-5168. *Cf.* GLAZER & FITZGIBBON §§ 2.3.2, n.10; 1.3.2 n.11 ("Because of the public policies embodied in the federal securities laws, counsel's responsibility for verifying the factual bases for opinions used to facilitate sales of securities is more demanding under Rule 10b-5 than under the state law standard applicable to opinions (of the type discussed in this book) that are customarily delivered at the closing to third parties in financial transactions.").

249 *See also* Part IV, Section B.3 of this Report.

250 *See* Part II of this Report, particularly note 28 and accompanying text.

251 In an offering under Rule 505 or Rule 506, the issuer must reasonably believe there are not more than 35 purchasers who are not "accredited investors." 17 C.F.R. §§ 230.505(b)(2)(ii), 506(b)(2)(i). Additionally, in offerings under Rule 506, the issuer must reasonably believe that each purchaser who is not an accredited investor, alone or with his purchaser representative, satisfies certain financial sophistication requirements. *Id.* § 230.506(b)(2)(ii).

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syndicated offerings or offerings in which some purchasers are not accredited), the opinion preparers also might want to review signed questionnaires returned by the purchaser and purchaser representative or factual certificates that elicit information such as the purchaser's relationship to the Company, its sophistication in financial or business transactions, and education, work and investment experience.

If the purchaser is relying on a professional adviser, the opinion giver may consider obtaining a factual certificate from that adviser to ensure that the person serving in that role satisfies the requirements of the applicable exemption. The opinion giver also may obtain additional factual information after reviewing the certificate of each purchaser and, if applicable, the certificate of each purchaser's professional adviser. Subject to the obligation of due care, an opinion giver normally limits its opinion to reliance on the accuracy of the factual representations made by the purchasers, professional advisors, if any, and the Company, as issuer.

In determining compliance with a limitation on the number of purchasers under a particular exemption, the opinion preparers often review, and generally rely upon, subscription agreements and each purchaser's factual certificate with respect to the beneficial ownership of the securities being purchased and information that may cause the Company to exclude the purchaser for purposes of the purchaser limitation.

ii. Information Concerning the Means of Solicitation

Except for certain offerings under Rule 504,[252] Regulation D requires that neither the issuer nor any person acting on its behalf offer or sell the securities by any form of general solicitation.[253]

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Similarly, to comply with Section 25102(f) of the Corporations Code, except for excluded purchasers as provided in Section 25102(f)(4) and California Code of Regulations, Section 260.102.12(1)**,** each purchaser must either have a pre-existing business or personal relationship with the issuer or have sufficient business or financial experience alone, or with his or her professional adviser, to be reasonably assumed to have the capacity to protect his or her own interests in connection with the transaction. CAL. CORP. CODE § 25102(f); CAL. CODE REGS. tit. 10, § 260.102.12(d).

252 *See* 17 C.F.R. § 230.504(b)(1).

253 In determining whether a "public" solicitation has occurred, the SEC generally has focused on whether the Company (as issuer), or a broker-dealer acting on behalf of it, had a relationship with the offeree that was both "substantive" and "preexisting." The existence of a preexisting, substantive relationship is commonly cited as a means to establish the absence of a "general solicitation." *See, e.g.*, E.F. Hutton & Company, Inc., SEC No-Action Letter (Dec. 3, 1985); Bateman Eichler, Hill Richards, Inc., SEC No-Action Letter, (December 3, 1985). It is not, however, the only means of demonstrating the absence of a "general solicitation." Regulation D; Accredited Investor and Filing Requirements, Securities Act Release No. 33-6825 [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,404, at 80,045 (March 14, 1989). *See also* Use of Electronic Media, Securities Act Release No. 33-7856 [2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,304, at 33,374 (Apr. 28, 2000). For a relationship with an offeree to be "substantive," the issuer or the broker-dealer either must be able to determine the financial circumstances or sophistication of the person with whom the relationship exists or the relationship must be of some substance or duration. Preexisting business relationships, while important, are not conclusive in determining whether or not at the time of the

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In a negotiated private placement of securities to a limited number of institutions or other "accredited" investors, opinion givers customarily rely on representations of both the Company and the placement agent, if any, and each of the purchasers as to the absence of a general solicitation. In a non-institutional syndicated offering or an exempt offering to a large number of purchasers, the general solicitation issue is more difficult and usually is a mixed question of fact and law.

Lawyers rendering opinions in these types of offerings normally require factual certificates from appropriate persons involved in the offering process (*e.g.*, placement agents and officers of the Company who are responsible for the solicitation). As with any other factual determination, the opinion preparer may also want to obtain additional factual information following review of these factual certificates. The opinion giver has a responsibility to exercise independent judgment in determining whether the Company has a reasonable basis for determining that the requirements pertaining to the method of solicitation are satisfied.

iii. Information Requirements

If the Company sells securities under Rule 505 or Rule 506 under Regulation D to a purchaser who is not an accredited investor, it must furnish to the purchaser specified information that is the same kind of information as is required in a registration statement filed under the 1933 Act or, under certain circumstances, information required by Regulation A. Compliance with this requirement necessarily requires a legal analysis of the rules pertaining to registered or Regulation A offerings. As a result, a request for a legal opinion in this context is not cost-effective in many circumstances.[254]

Occasionally, the opinion giver is asked to provide negative assurance regarding the adequacy of disclosure documents furnished to investors by the Company. Although negative assurance is customarily rendered to underwriters in registered offerings, providing negative

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offering the potential investor had a preexisting substantive relationship with the issuer or the broker-dealer. *See, e.g.*, Mineral Lands Research and Marketing Corporation, SEC No-Action Letter (Dec. 4, 1985). A relationship with an offeree is not considered "preexisting" unless the relationship was established before the offering commenced or, in case of a broker-dealer participating in an offering, before the broker-dealer's participation in the offering commenced. *See* IPONET, SEC No-Action Letter (July 23, 1996).

In addition to the general prohibition on advertising, Section 25102(f) imposes a separate "preexisting personal or business relationship" requirement. CAL. CORP. CODE § 25102(f). A relationship of employer-employee, or as a security holder of the issuer, or as a customer of a broker-dealer, investment adviser or other person, does not necessarily involve contacts of a nature that are sufficient to establish a "preexisting personal or business relationship." CAL. CODE REGS. tit. 10, § 260.102.12.

254 Regulation D does not prescribe any specific information disclosure requirements for offerings made under Rule 505 or 506 exclusively to accredited investors or for offerings made under Rule 504. Offerings under Rule 504 may require delivery of a disclosure document prescribed by state law. 17 C.F.R. § 230.504(b)(1). Similarly, Section 25102(f) of the Corporations Code does not require specific disclosure in order to satisfy the exemption. Sales of securities under either exemption, however, are subject to the general anti-fraud provisions of the federal and state securities laws.

assurance in an exempt offering is generally not appropriate.[255] The provision of negative assurance statements should be limited to registered offerings or to transactions in which an offering document comparable to a statutory prospectus under the 1933 Act is being delivered and the process for preparing the offering document is comparable to that followed in a registered offering.[256]

iv. Integration

To be certain that the exemption from federal registration or California qualification is available in a particular transaction, the opinion giver must determine that the transaction is not part of other offers or sales of securities that, taken together, would not qualify for the exemption.[257] These requirements often involve mixed questions of law and fact. The opinion giver will typically rely upon officers' certificates and may review the Company's minute book and stock book[258] in an effort to substantiate the factual basis for the determination of whether there are other transactions that may have to be "integrated" with the current offering.

c. Assumptions and exceptions

Given the heavily fact-based conditions of Regulation D, opinions based on it customarily are highly qualified and rely expressly on assumptions that various representations and statements are true and accurate.

Opinions need not be qualified with respect to events that may occur after the delivery of the opinion. The opinion giver need not expressly assume the absence of future offerings that might be integrated with the exempt transaction, the satisfaction of post-closing filing requirements or future compliance with applicable law, since it is generally understood that the opinion does not address events occurring after its delivery.

Scope limitations to the opinion may also be appropriate. In a negotiated private placement of securities to a limited number of institutions or other "accredited" investors, the opinion recipient may agree that the opinion giver may assume certain facts in support of the opinion.[259] When the opinion giver varies customary practice by limiting the scope of the

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255 *See Negative Assurance Report*. The purpose of negative assurance is to assist the recipient in establishing a due diligence or similar defense. *See also* Part IV, Section B.3 of this Report, particularly notes 68-73. That purpose is served when negative assurance is provided to third parties who can avoid liability in securities offerings by establishing such a defense. It is not served by providing negative assurance to ultimate purchasers of securities in contrast to underwriters (or other financial intermediaries). Requests that negative assurance be provided to those persons or to issuers of the securities are inappropriate.

256 These transactions include many Rule 144A offerings and some Regulation S offerings.

257 17 C.F.R. § 230.502(a); CAL. CODE REGS. tit. 10, § 260.102.12(b).

258 *See* Part V, Section D.1 of this Report.

259 Generally, knowledge qualifiers do not limit the customary diligence lawyers undertake to support the opinion, and the meaning of the opinion is the same whether or not the phrase is used. *See TriBar Report* § 2.6.1 (inclusion of the phrase "to our knowledge" in an opinion does not by itself (i) label the factual material involved as unreliable or (ii) state a limitation on the investigation required by customary diligence). The obligation of the opinion giver to exercise customary diligence in establishing the factual basis for an

(footnote continued on next page)

investigation conducted, this limitation should be stated explicitly in the opinion and the factual investigation actually conducted by the opinion giver should be described.[260]

3. Exemption from Federal Registration or State Law Qualification — Resales

The typical "Rule 144 opinion" reads as follows:

> Based on the foregoing facts, and subject to the assumptions set forth above, it is our opinion that the sale of the securities was exempt from the registration requirements of the 1933 Act by virtue of the exemption provided by [Section 4(1) thereof and] Rule 144 thereunder.

a. What it means

Issuers commonly place stop transfer orders with their transfer agents and cause legends to be placed on stock certificates for shares that have been sold in reliance upon the Section 4(2) ("private offering") exemption. Transfer agents are generally considered to have a duty to use reasonable diligence to prevent the shares from being transferred in violation of the 1933 Act. As a result, transfer agents typically request opinions of counsel on transfers of shares that initially were sold in a private offering. Rule 144 provides a safe harbor for certain of these transfers. The Rule 144 opinion allows non-affiliates to resell restricted securities without registration, and affiliates to sell restricted and non–restricted shares without registration.

(footnote continued from previous page)

opinion is implicit in every opinion letter. However, an opinion giver can limit or disclaim that obligation by including in the opinion letter an express statement describing the factual investigation it conducted on a particular point and making clear that no other investigation was conducted. Often, this is done simply by adding the phrase "without investigation." Thus, if the opinion giver intends the phrase "to our knowledge" to excuse it from performing customary factual diligence, the opinion should clearly disclose that limitation. *ABA Guidelines* § 3.4. *Cf.* Ad Hoc Committee on Third-Party Legal Opinions of the Business Law Section of the Washington State Bar Association, *Report on Third-Party Legal Opinion Practice in the State of Washington*, Illustrative Opinion, n.18 (1999) ("Washington practice and understanding [on meaning of "to our knowledge"] represents a point of strong divergence from TriBar II."). In the context of securities law opinions, the opinion giver should consider whether, based on its knowledge of the facts, a disclaimer of investigation would be sufficient to make the opinion not misleading or to sufficiently "bespeak caution" to negate reliance. *See* Kline v. First Western Government Securities, Inc., 24 F.3d 480, 486 (3d Cir. 1994).

260 *See TriBar Report* § 1.5 (A material departure from any aspect of customary practice (including diligence or usage) should be expressly described in the opinion letter. For example, a mere listing in an opinion letter of documents examined is not sufficient to give notice to the recipient that the opinion giver reviewed only the listed documents (rather than all of the documents that would be covered by customary practice)); *TriBar Report* § 1.4(c) (Opinion letters often state (immediately before the opinion paragraphs) that the opinions being expressed are based on a review of certain identified documents "and such other investigation as we [the opinion giver] have deemed appropriate." The term "investigation" is generally understood to relate to both law and fact. Thus, the "such other investigation" statement merely emphasizes that the opinion letter is given in accordance with customary practice and its omission is not sufficient, by itself, to indicate that customary practice is not being followed).

b. What sort of information lawyers customarily rely upon to deliver this opinion

i. Affiliate Status

Rule 144 defines an affiliate of an issuer as a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the issuer.[261] This is a subjective "facts and circumstances" test. As with opinions relating to the private offering exemption, the opinion should be understood in the context in which it is being rendered.[262] In the absence of reasons to make further inquiry, the opinion giver customarily relies on a factual certificate of the selling shareholder.

ii. Holding Period

For restricted securities to be sold under Rule 144, Rule 144(d) requires that at least one year must have elapsed since the later of the acquisition of the securities from the issuer or from an affiliate of the issuer. In determining whether this requirement has been satisfied, the opinion preparers usually obtain information as to the circumstances of the ownership of the shares in question, such as information as to when the shares were first issued by the Company and which exemption from registration was relied upon by the Company. The opinion preparers may also seek to ascertain what transfers, if any, of those shares were made prior to their acquisition by the selling shareholder to determine whether any events subsequent to the initial issuance of the shares might raise doubt about compliance with the holding period. In addition to general inquiry of the selling shareholder, opinion preparers customarily rely on a review of stock certificates (for legends, dates, etc.) for the shares in question and the selling shareholder's representation letter provided to its broker.

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261 17 C.F.R. § 230.144(a)(1).

262 ABA Formal Opinion 335, note 247, cites two extreme examples. In the first, where a lawyer is asked to issue an opinion concerning a modest amount of a widely traded security by a responsible client, whose lack of relationship to the issuer is well known to the lawyer, the Opinion states that the lawyer may ordinarily issue the opinion with considerable confidence. At the other extreme is a lawyer asked to prepare an opinion letter covering a substantial block of a little known security, when the client (be it selling shareholder or broker) appears reluctant to disclose exactly where the securities came from or the surrounding circumstances. In such event the question may arise whether the ostensible sellers are intermediaries for controlling persons or statutory underwriters. In that case the Opinion calls for "searching inquiry."

The SEC has made clear its view that a lawyer should not render an opinion on the availability of an exemption permitting the resale of unregistered securities based on hypothetical facts. *See* Distribution By Broker-Dealers of Unregistered Securities, Securities Act Release No. 33-4445 [Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶¶ 3090.101; 48215.835; 22,753-59 (Feb. 2, 1962) (The propriety of an attorney's professional conduct will be open to serious question if he furnishes an opinion on the resale of unregistered securities "based solely on hypothetical facts which he has made no effort to verify, and if he knows that his opinion will be relied upon as the basis for a substantial distribution of unregistered securities."); *see also* Securities Act Release No. 33-5168, [Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 22,760 (July 7, 1971).

iii. Current Public Information

Rule 144(c) requires that current public information with respect to an issuer must be available at the time of sale. If the Company files periodic reports with the SEC, the opinion giver may rely on the Company's representation on the front cover of its most recent report, which contains a box indicating whether it has filed all reports required during the preceding 12 months for purposes of determining whether it is in compliance with the current public information requirement of Rule 144, unless the opinion giver otherwise has reason to believe that the representation is incorrect.[263]

If the Company is not subject to the periodic reporting requirements, it may still satisfy the current public information requirement if it disseminates to all interested persons on an ongoing and continuous basis certain information specified in Rule 15c2-11(a)(5) under the 1934 Act.[264] The opinion preparers must perform sufficient investigation, however, to have adequate assurances as to both the quality of the information made publicly available by the Company and its widespread dissemination on an ongoing basis. As discussed above, a conclusory statement on an important issue without any supporting analysis is ordinarily not acceptable in these circumstances.

iv. Volume Limitation

Rule 144(e) limits the amount of securities that can be sold by a seller during any three-month period to the greater of one percent of the outstanding securities of the same class or the average weekly trading volume during the four calendar weeks preceding the sale. Opinion givers customarily rely upon the selling shareholder's representation letter (as well as the Form 144, if required) to determine the amount of shares intended to be sold and compliance with the volume limitation. Many opinion preparers also review reports of trading volume, which are widely available in newspapers or on the Internet, and/or review the Company's most recent periodic report to determine the number of shares outstanding.

v. Manner of Sale

Rule 144(f) and (g) require that the shares be sold either through a broker or directly to a market maker. No solicitation of orders is permitted by either the broker or the selling shareholder under the Rule. Opinion givers customarily rely upon the broker's and selling shareholder's representation letters in this regard.

c. Assumptions and exceptions

As with opinions relating to the private offering exemption, the opinion letter usually identifies the sources of the information on which the opinion giver is relying. Many opinion givers will not provide a Rule 144 opinion until the sale has taken place, thereby permitting the

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263 17 C.F.R. § 230.144(c)(1); Resale of Registered and Other Securities, Securities Act Release No. 33-6099, Ques. 16 [Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 27054 (Aug. 2, 1979).

264 17 C.F.R. § 230.144(c)(2); Securities Act Release No. 33-6099, Ques. 20.

opinion giver to confirm the facts relevant to the sale prior to delivering the opinion. When a "Rule 144 opinion" is delivered prior to the date of sale, opinion givers customarily assume that between the date of the opinion and the date of sale the Company will continue to satisfy the current public information requirements, that the selling shareholder and broker will comply with their prior representations, that the selling shareholder will not make sales after the date of the opinion that cause the selling shareholder to exceed the volume limits of Rule 144 and that the Form 144, if required, is properly prepared and filed.

VI. SPECIAL ISSUES

A. Contracts Not Governed By California Law

Opinion givers normally include a statement that limits coverage of their opinion to the law of a specific state. Opinion letters may also state that they cover federal law. A typical statement of that sort reads as follows:

> Our opinions expressed herein are limited to the law of the State of California and to the federal laws of the United States. We express no opinion as to the application or effect of the law of any other jurisdiction.

Even when the qualification stated in the second sentence is not expressly stated in an opinion, the Committee is of the view that, by customary usage, an opinion delivered by a California lawyer should not be read to cover the substance or effect of the law of any jurisdiction other than California unless specifically stated otherwise.[265] This is particularly important if a contract is governed by the laws of another jurisdiction.

1. Advising on the Law of Another Jurisdiction

As clients expand the scope of their businesses and transactions, California opinion givers are increasingly called upon to review documents in which the "chosen law" is that of a jurisdiction other than California. While courts occasionally struggle with defining the permissible reach of a lawyer's "authorized" practice,[266] an opinion giver may properly advise a

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265 *See TriBar Report* §§ 1.2(e), 1.9(o), 4.1. As stated by *TriBar*:

> If in identifying the law covered [in] an opinion letter [the opinion] does not state that it covers federal law (or the law of a particular state), that law is understood, as a matter of customary usage, not to be covered except to the extent that it is expressly addressed by specific opinions in the letter.

Id. § 4.1.

If the opinion letter does not state that it covers the law of a particular jurisdiction, then the opinion recipient may reasonably believe that the opinion letter covers the law chosen in the Agreement.

266 *See* Birbrower, Montalbano, Condon & Frank v. Superior Court, 17 Cal. 4th 119, 70 Cal. Rptr. 2d 304 (1998).

client on the law of another jurisdiction, as long as the lawyer has adequate familiarity with the relevant law:

> ... a lawyer conducting activities in a lawyer's home state may advise a client about the law of another state, a proceeding in another state, or a transaction there, including conducting research in the law of the other state, advising the client about the application of that law, and drafting legal documents intended to have legal effect there. There is no per se bar against such a lawyer giving a formal opinion based in whole or in part on the law of another jurisdiction, but a lawyer should do so only if the lawyer has adequate familiarity with the relevant law.[267]

2. Opinions on Choice-of-Law Provisions

Historically, opinion givers have exercised caution in rendering opinions on the enforceability of choice-of-law provisions, even where the Agreement's choice of law is California.

Developments in customary practice and in the law have led the Opinions Committee of the Business Law Section and this Committee to conclude that, under the circumstances described below, choice-of-law provisions are generally enforceable and that California opinion givers therefore need no longer routinely except the parties' choice of law from their opinions.

Generally a "contract is to be interpreted according to the law and usage of the place where it is to be performed; or, if it does not indicate a place of performance, according to the law and usage of the place where it is made."[268] An exception to this principle is provided by

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267 RESTATEMENT § 3, cmt.e. *See also* Condon v. McHenry, 65 Cal. App. 4th 1138, 76 Cal. Rptr. 2d 922 (1998), (holding that Colorado attorney providing estate planning and probate advice to California co-executor not practicing law in California in violation of Section 6125 of the Business and Professions Code). The Restatement's emphasis (quoted in the text above) on "adequate familiarity with the relevant law" bears emphasis; lawyers should be cautioned that in advising on the law of a jurisdiction in which the lawyer is not authorized to practice law, he or she will likely be held to the standard of competence that governs in-state lawyers.

On April 8, 2004, the California Supreme Court adopted the recommendations of its Multijurisdictional Practice Implementation Committee, and added Rules 964-966 to the California Rules of Court (Rules Relating to Attorney Admission and Disciplinary Proceedings and Review of State Bar Proceedings). The new rules permit four categories of out-of-state lawyers to provide legal services in California without being deemed engaged in the unauthorized practice of law in this state. The new rules require that those taking advantage of them agree to be subject to the jurisdiction of the State Bar of California. The new rules were effective November 10, 2004. For background, see the Report of the California Supreme Court Multijurisdictional Practice Implementation Committee, *Final Report and Proposed Rules* (March 10, 2004) available as of the date of this Report at www.courtinfo.ca.gov/reference/documents/mjpfinalrept.pdf. *See also* Report of the Commission on Multijurisdictional Practice, *Client Representation in the 21st Century* (American Bar Association 2002) (adopted by the ABA's House of Delegates on August 12, 2002) available as of the date of this Report at www.abanet.org/cpr/mjp/final_mjp_rpt_121702.pdf.

268 CAL. CIV. CODE § 1646.

California Civil Code Section 1646.5 (whose re-enactment was pending at the time of the 1989 Report):

> Notwithstanding Section 1646, the parties to any contract, agreement, or undertaking, contingent or otherwise, relating to a transaction involving in the aggregate not less than two hundred fifty thousand dollars ($250,000), including a transaction otherwise covered by subdivision (1) of Section 1105 of the Commercial Code, may agree that the law of this state shall govern their rights and duties in whole or in part, whether or not the contract, agreement, or undertaking or transaction bears a reasonable relation to this state. This section does not apply to any contract, agreement, or undertaking (a) for labor or personal services, (b) relating to any transaction primarily for personal, family, or household purposes, or (c) to the extent provided to the contrary in subdivision (2) of Section 1105 of the Commercial Code.[269]

Moreover, as discussed at length in Appendix 10 of the Remedies Report, California courts have increasingly recognized the "strong policy considerations favoring the enforcement of freely negotiated choice-of-law clauses."[270]

Given these case law developments and the legislative policy reflected in California Civil Code Section 1646.5, the Remedies Report concludes that opinion givers should generally be able to give opinions that both "outbound" (choice of law other than California) and "inbound" (choice of California law) provisions are enforceable:

> Given this standard [permitting choice of the law of a jurisdiction having a reasonable relation to the transaction or to a party], the [Exceptions] Subcommittee concluded that, where the chosen law is the law of the State of California and there is some articulable basis for choosing California law (*e.g.*, domicile/place of incorporation of a party), there should be no need either (1) to disclaim any opinion regarding the enforceability of the choice of law provision, or (2) to address separately the choice of law in the exceptions to the opinion.
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> . . . .
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> Where the law chosen to govern an agreement being opined upon is the law of another state, customary practice (which, formerly, often involved engaging separate counsel qualified in the jurisdiction whose law was chosen to give the remedies opinion) now greatly favors permitting the primary opinion giver to render an opinion to the effect that, if the law

269 CAL. CIV. CODE § 1646.5. Section 1646.5 is modeled virtually word-for-word after New York General Obligations Law § 5-1401(1). *See* N.Y. GEN. OBLIG. § 5-1401(1).

270 *See* Appendix 10 ("Exceptions Subcommittee Report") to the Remedies Report, Annex B, Discussion, no. 1, "Choice of Law," quoting from the Supreme Court's decision in *Nedlloyd Lines B.V. v. Superior Court*, 3 Cal. 4th 459 (1992).

> of the State of California were held to apply to the agreement, notwithstanding the choice of law of another jurisdiction, the agreement would be enforceable.[271]

The Committee concurs in these observations and recommendations.

California opinion givers are often called upon to give opinions on agreements whose chosen law is that of another jurisdiction. For example, many New York and international banks and financial institutions routinely include New York choice-of-law provisions in their loan documentation with California borrowers. Often this documentation has been prepared by New York lawyers who are acting as the institution's counsel, and yet California counsel for the borrower is asked for an opinion on the enforceability of the loan documentation. Historically, the borrower was requested to retain special counsel to render a remedies opinion under the chosen law (in this instance, New York). Borrowers have understandably objected to the additional cost of this procedure. An alternative approach, now increasingly accepted, as noted by the Remedies Report, is for borrower's counsel to give the remedies opinion *as if* the law of the borrower's jurisdiction (in this instance, California) applied to the Agreement. When this alternative is followed, the responsibility for rendering advice to the lender, including rendering any remedies opinion, under the law of the chosen jurisdiction (in this instance, New York) rests with lender's counsel.[272]

The Remedies Report suggests two forms of opinion for California counsel who are asked for a choice-of-law opinion on an Agreement whose chosen law is a jurisdiction other than California. The first form addresses the situation in which California counsel is providing a remedies opinion on the entire agreement *as if* the Agreement were governed by California law *and* the other party requests a separate, specific opinion on the enforceability of the choice-of-law provision. The Remedies Report explanation of this opinion is as follows:

> It is not uncommon for an opinion recipient who has agreed to accept a remedies opinion rendered under California law with respect to an agreement governed by other law to request in addition a separately stated opinion to the effect that the choice of law set forth in the agreement will be respected by the courts of the State of California. California lawyers have historically declined to give that opinion. In light of the considerable development in the case law over the last decade and a half, however, the Subcommittee believes it is appropriate for this practice to change. If the chosen law is the law of another state, and there is either a substantial relationship to that other state or another reasonable basis for choosing the law of that state, a California court should give effect to that choice of law, unless it is determines both that (i) the application of the chosen law would be contrary to a fundamental policy of the jurisdiction whose law would apply in the absence of a choice-of-law clause and (ii)

271 Appendix 10 ("Exceptions Subcommittee Report") to the Remedies Report, Annex B, Discussion at B-1 & B-2.

272 *See* Appendix 4 ("Report of the Threshold Committee") to the Remedies Report at 10-11.

> the other jurisdiction had a materially greater interest in the application of its law than does the chosen-law state.[273]

An illustrative form of such an opinion follows:

> Assuming a court of the State of California has jurisdiction, in a proceeding in a court of the State of California for the enforcement of the Agreement, and based on [describe contact or basis for choosing law of chosen state], the court should, assuming that [the clause whereby the parties expressly agree that the Agreement will be governed by the law of the chosen-law state] is enforceable under the law of [the chosen-law state], give effect to that clause of the Agreement.[274]

Where the California opinion giver is *not* rendering an "as if" remedies opinion but is only addressing the enforceability of the Agreement's specific choice-of-law provision, the choice-of-law opinion may be specifically qualified as follows:

> Assuming a court of the State of California has jurisdiction, in a proceeding in a court of the State of California for the enforcement of the Agreement, and based on [describe contact or basis for choosing law of chosen state], the court should, assuming that [the clause whereby the parties expressly agree that the Agreement will be governed by the law of the chosen-law state] is enforceable under the law of [the chosen-law state], give effect to that clause of the Agreement, except to the extent that any provision of the Agreement (i) is determined by the court to be contrary to a fundamental policy of the state whose law would apply in the absence of a choice-of-law clause, and (ii) that state has a materially greater interest in the determination of the particular issue than does the state whose law is chosen.[275]

As noted in the Remedies Report, "California opinion givers do not customarily opine as to what constitutes a fundamental policy of the State of California."[276]

3. Limits on the Parties' Freedom to Adopt Choice-of-Law Provisions

Although choice-of-law provisions are generally enforceable, the parties' freedom to select a law that will govern all aspects of the Agreement is not unlimited. The most notable examples are the UCC provisions establishing mandatory choice-of-law rules for the perfection,

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273 Appendix 10 ("Exceptions Subcommittee Report") to the Remedies Report, Annex B, Discussion at B-2.

274 *Id.*

275 *Id.*

276 *Id*. at B-3. For examples of fundamental policies of California, see discussion at B-3 through B-5.

the effect of perfection or nonperfection, and priority, of a UCC security interest.[277] Where these provisions apply, they cannot be altered by agreement.[278]

Accordingly, when rendering an opinion on the enforceability of an Agreement containing a choice-of-law provision, or separately opining on a choice-of-law provision, an opinion giver should review the substantive law governing the Agreement to ensure that that law does not establish a mandatory choice of law or should except from the opinion the effect of mandatory choice-of-law provisions.

B. Selected Matters Governed By the Laws of Other States

1. Delaware Corporate Law

As noted above in the citation to the Restatement's discussion of the competence of a lawyer to advise a client about the law of another state,[279] there is no inherent restriction on opinion givers rendering opinions on the law of a foreign jurisdiction, assuming the lawyer has "adequate familiarity with the relevant law."[280] Given the preeminence of Delaware corporate law, and the widespread adoption of that law by companies electing to incorporate in Delaware, many California lawyers are increasingly comfortable rendering opinions on the incorporation and good standing of Delaware corporate clients and on certain other "routine" corporate matters, such as the due authorization of an agreement by the corporate client.[281] The TriBar Report is in accord.[282] The Committee joins with Glazer & FitzGibbon in noting the limits on this practice:

> Lawyers not admitted to practice in Delaware customarily render opinions on routine questions, such as a company's due incorporation under the Delaware corporation law when they represent Delaware corporations on a regular basis and follow developments in that law. Non-Delaware lawyers, however, normally do not render opinions on more difficult questions of Delaware corporation law or on questions arising under Delaware commercial law. In those circumstances, they usually rely on an opinion

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277 *See* U.C.C. §§ 9-301 to 9-307 and U.C.C. § 1-105(2). The U.C.C. Committee of the Business Law Section, in its current draft of its updated opinions report (exposure draft of September 9, 2004) takes the position that a "Security Interest Opinion" does not include a choice of law opinion. *Id*. § 2.4.

278 *See* TriBar Opinion Committee, *U.C.C. Security Interest Opinions — Revised Article 9, Appendix B ("Perfection Opinions Under the Law of Another Stat*e"), 58 BUS. LAW. 1450 (2003).

279 *See* Part VI, Section A.1 of this Report.

280 RESTATEMENT § 3 cmt.e.

281 In rendering opinions for Delaware and other foreign corporate clients having their headquarters in California or other substantial contacts with California, opinion givers should be aware of the potential application of Section 2115 of the Corporations Code to the opinion. *See* Part V, Section B.2.d of this Report.

282 *See TriBar Report* §§ 4.1 n.85, 6.1.

> of Delaware counsel or deal with the issue in some other way, for example by relying on an express assumption.[283]

The Committee further notes that references to the term "Delaware General Corporation Law" are generally understood to refer to the Delaware corporation statute, applicable requirements of the Delaware constitution and reported decisions interpreting these provisions.

2. Other State Laws

In a securities financing, Company counsel customarily renders an opinion to the purchasers with respect to the securities that they are acquiring from the Company.[284] It is universally recognized and accepted that an opinion on due authorization and valid issuance of those securities does *not* cover compliance with federal or state securities laws.[285]

Blue Sky Memoranda. California lawyers for the lead underwriter in an underwritten public offering, and occasionally the lawyers for the issuer in a private placement of securities, regularly prepare a "Blue Sky Memorandum" addressing the qualification of the offering in selected (often all) states or the availability of exemptions from registration or qualification in selected states. These memoranda are intended as guidance for the underwriters and broker-dealers participating in the offering. They are not intended as legal opinions, but rather as advice based upon counsel's examination of standard unofficial compilations of the examined states' "blue sky" or securities laws, and communications, in certain instances, with the authorities administering such laws. The memorandum typically states that the advice it provides is necessarily subject to the exercise of broad discretionary powers vested in the states' securities administrators (subject to the preemptive provisions of Section 18 of the 1933 Act). The memorandum typically recites that no special rulings of the state administrators or opinions of local counsel have been obtained (except as otherwise indicated), and reiterates that the authors are members of the State Bar of California and do not purport to be experts as to the laws of any jurisdiction other than California.

Blue Sky Opinions. As noted above with respect to opinions on Delaware corporate law, there is no inherent restriction on counsel's rendering opinions on the law of a foreign jurisdiction if counsel has adequate familiarity with the relevant law. Experienced blue sky lawyers may render opinions about the securities laws of states in which they are not admitted; however, these opinions are infrequently given. In a transaction in which a question of state securities law is both significant and subject to interpretation, an opinion of local counsel typically is obtained.

VII. OPINIONS NOT NORMALLY REQUESTED OR GIVEN

A legal opinion expresses the opinion giver's professional judgment on questions of law or procedure. For example:

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283 GLAZER & FITZGIBBON § 2.7.3 at 64-65 (footnotes omitted).

284 *See* Part IV, Sections D.1, D.2 and D.3 of this Report.

285 *See 1989 Report* at 40-41; *Accord* § 19(a); *TriBar Report* § 6.2.2 n.129; GLAZER & FITZGIBBON § 10.2.1.

- Is the transaction to be entered into by the client within its corporate power and authority?

- Has the transaction been duly authorized by the client's board of directors and shareholders?

- Has the client secured all of the consents necessary to enable it to enter into the transaction?

- Will the opinion recipient, if the client breaches the Agreement in a material way, have available to it, under the law governing the agreement, the remedies for which it has bargained?

Requests for "opinions" on essentially factual questions, opinions that are not cost effective and opinions that address questions beyond the competence of a business lawyer are generally viewed as inappropriate. Some of those opinions are discussed below.[286]

A. Title to and Transfer of Assets

An opinion giver occasionally will be asked for an opinion that the Company has "good and marketable title" or "good and valid title" to its assets or that the Company has transferred title to certain assets to a buyer. The Committee is of the view that lawyers should not be asked for an opinion on title to assets.[287]

Sometimes an opinion giver is asked for an opinion on the form of the document that is intended to transfer title. An illustration of the form of such an opinion follows:

> ... The [bill of sale] is sufficient as to form to transfer the Company's right, title and interest in and to the assets specified in the Agreement to the Buyer.

286 Readers of this Report may also wish to review the list of disfavored opinions set forth in the *ABA Guidelines* § 4. *See also* the discussion in Part IV, Section B of this Report.

287 In connection with the purchase and sale of assets, seller's counsel may be asked for an opinion that the assets are free and clear of all liens, encumbrances, and adverse claims. In giving opinions on asset sales, opinion givers should consider the application of Division 6 of the Uniform Commercial Code relating to bulk sales. California is one of a few states that has not repealed Division 6 of the Uniform Commercial Code, despite the long-standing recommendation by the Uniform Commercial Code Committee of the Business Law Section of the California Bar Association that the California Legislature should do so. (*Report of the UCC Committee of the Business Law Section of the State Bar of California Recommending Repeal of Division 6 of the California Commercial Code Regarding Bulk Sales dated December 1, 2003*.) For a variety of reasons, it has become standard business practice for many buyers in California to waive compliance with the California bulk sales law. For this reason, and because title to most types of personal property is affected significantly by facts that a lawyer cannot determine without great cost or at all, lawyers generally do not render an opinion that assets are free and clear of all liens, encumbrances, and adverse claims (except for "free from adverse claim" opinions with respect to securities and instruments).

The Committee wishes to point out, however, that specific issues relating to real estate and the application of the Uniform Commercial Code to the transfer of assets are beyond the scope of this Report.

B. Fraudulent Transfers and Other Insolvency-Related Opinions

An opinion on the enforceability of an Agreement does not address the effect of fraudulent transfer laws. The "bankruptcy exception" to the standard remedies opinion excludes the effect of fraudulent transfer laws from the opinion.[288]

A specialized practice has developed in structured finance involving the rendering of opinions to rating agencies and investors in connection with the establishment of special purpose entities acquiring assets from related parties. In these transactions, opinion givers do give reasoned opinions on bankruptcy-related issues, including substantive consolidation, "true sales" and restrictions on access to bankruptcy.[289]

C. Opinions Referenced Elsewhere in this Report

The following opinions are addressed elsewhere in this Report and, for the reasons there indicated, should normally not be requested or given:

Description of Opinion	Report Reference
No violation of any law	Part IV.B.1
No violation of any agreement	Part IV.B.1
Due authorization/valid issuance of all shares of capital stock	Part IV.B.1. & V.D.5
Qualification in all jurisdictions	Part V.A.5
Outcome of litigation	Part IV.B.2
Financial statements or economic valuation	Part IV.B.6

288 *See* Appendix 10 ("Report of the Exceptions Committee") to the Remedies Report at 4-6.

289 *See* TriBar Opinion Committee, *Opinions in the Bankruptcy Context: Rating Agency, Structured Financing, and Chapter 11 Transactions*, 46 BUS. LAW. 717 (1991).

APPENDIX A

GLOSSARY OF DEFINED TERMS

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GLOSSARY OF DEFINED TERMS

Defined Term	**Explanation**
"1933 Act"	Securities Act of 1933, as amended, 15 U.S.C. §§ 77a-77aa
"1934 Act"	Securities Exchange Act of 1934, as amended, 15 U.S.C. §§ 78a - 78mm
"1940 Act"	Investment Company Act of 1940, as amended, 15 U.S.C. §§ 80a-1 to 80a-64
"1989 Report"	Committee on Corporations, State Bar of California, *1989 Report of the Committee on Corporations Regarding Legal Opinions in Business Transactions in* 1990 CALIFORNIA OPINION REPORTS (1990) and in 45 BUS. LAW. 2169 (1990)
"2002 Opinion Reports"	Business Law Section & Real Property Section, State Bar of California, CALIFORNIA OPINION REPORTS (2002)
"ABA Committee"	Legal Opinions Committee, American Bar Association
"ABA Formal Opinion 335"	ABA Committee on Ethics and Prof'l Responsibility, Formal Op. 335 (1974), 60 ABA JOUR. 488 (1974)
"ABA Guidelines"	Committee on Legal Opinions, American Bar Association, Guidelines for the Preparation of Closing Opinions, 57 BUS. LAW. 875 (2002)
"ABA Model Rules"	ABA Model Rules of Professional Conduct (2002)

Defined Term	**Explanation**
"ABA Principles"	Committee on Legal Opinions, Section of Business Law, American Bar Association, *Legal Opinion Principles*, 53 BUS. LAW. 831 (1998)
"Accord"	Committee on Legal Opinions, American Bar Association, *Third-Party Legal Opinion Report, including the Legal Opinion Accord, of the Section of Business Law, American Bar Association*, 47 BUS. LAW 167 (1991)[*]
"Agreement"	The contract or other written instrument evidencing obligations of the Company and pursuant to which the opinion is being rendered
"articles"	When referring to the organizational document of the Company, the articles of incorporation or the certification of incorporation, as the case may be, and all amendments and restatements thereof, including all certificates of determination of the rights, preferences, privileges, and restrictions of outstanding shares or any class or series of shares
"Ballantine & Sterling"	BALLANTINE & STERLING, CALIFORNIA CORPORATION LAWS (R. Bradbury Clark, editor) (4th ed. 2004)
"Business Law Section"	Business Law Section of the State Bar of California
"Committee"	Corporations Committee of the Business Law Section of the Business Law Section of the State Bar of California
"Company"	The business entity that is the subject of the opinion referred to in the opinion letter.
"CSL"	California Corporate Securities Law of 1968, as amended, CAL. CORP. CODE §§ 25000 – 25707

[*] See note 3 of the Report.

Defined Term	**Explanation**
"Exhibit 5 opinion"	A legal opinion included as part of a registration statement filed under the 1933 Act pursuant to Item 601(b)(5)(i) of Regulation S-K under the 1933 Act
"FASB"	Financial Accounting Standards Board
"Field Treatise"	Arthur Norman Field, LEGAL OPINIONS IN BUSINESS TRANSACTIONS (2003)
"Franchise Tax Board"	California Franchise Tax Board
"Fuld"	James Fuld, *Legal Opinions in Business Transactions—An Attempt to Bring Some Order Out of Some Chaos*, 28 BUS. LAW. 915 (1973)
"GCL"	California General Corporation Law, CAL. CORP. CODE §§ 100-2319
"Glazer & FitzGibbon"	Donald W. Glazer, Scott FitzGibbon & Steven O. Weise, GLAZER & FITZGIBBON ON LEGAL OPINIONS*:* DRAFTING, INTERPRETING AND SUPPORTING CLOSING OPINIONS IN BUSINESS TRANSACTIONS (2d ed. 2001)
"Marsh's California Corporation Law"	Harold Marsh, Jr., R. Roy Finkle, and Larry W. Sonsini, MARSH'S CALIFORNIA CORPORATION LAW (4th ed. 2004)
"Material Agreements"	The list of contracts and other written instruments that the parties agree are material to the transaction and are the subject of specific portions of the opinion letter.
"Negative Assurance Report"	Special Report of the Task Force on Securities Law Opinions, ABA Section of Business Law, Negative Assurance in Securities Offerings, 59 BUS. LAW 1513 (2004)
"opinion giver"	The lawyer or law firm in whose name an opinion is signed.
"opinion preparer(s)"	The lawyers in the law firm who prepare an opinion letter.

Defined Term	**Explanation**
"opinion recipient"	The addressee of the opinion letter, and others, if any, expressly granted permission by the opinion giver to rely on the opinion letter.
"Real Estate Report"	Real Property Law Section, State Bar of California & Real Property Section, Los Angeles County Bar Association, *Legal Opinions in California Real Estate Transactions* (1987), 42 BUS. LAW. 1139, 1156 (1987)
"Remedies Report"	Opinion Committee, Business Law Section, State Bar of California, *Report on Third-Party Remedies Opinions* (September 2004)
"Report"	Corporations Committee, Business Law Section, State Bar of California, *Legal Opinions in Business Transactions* (*Excluding the Remedies Opinion*)
"Restatement"	RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS (2000)
"Rules of Conduct"	California Rules of Professional Conduct
"SEC Filings Report"	Special Report of the Task Force on Securities Law Opinions of the ABA Section of Business Law, *Legal Opinions in SEC Filings*, 59 BUS. LAW 1505 (2004)
"SEC"	Securities and Exchange Commission
"Secretary of State"	California Secretary of State
"TriBar Report"	TriBar Opinion Committee, *Third-Party "Closing" Opinions*, 53 BUS. LAW. 591 (1998)

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