

Rendering Third-Party Legal Opinions on LLC Status, Power, Action, Enforceability and Membership Interests

Drafting Defensible Opinions and Minimizing Preparer Liability Risks

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Rendering Third-Party Legal Opinions on LLC Status, Power, Action, Enforceability and Membership Interests

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- Preparing LLC Opinion Letters
 - Due Formation, Good Standing, Valid Existence, Power and Authority
 - 1. The Company is duly formed as a limited liability company. [Based solely on the Borrower Good Standing,*] the Company validly exists in good standing as a limited liability company under the laws of the State of Delaware.
 - * We often include an assumption “with respect to the Guarantor’s good standing and valid existence, we have relied solely upon the Guarantor Good Standing, a copy of that certificate is attached to this letter”

- Due Formation
 - Do not use the terms “duly organized”
 - Corporate terms which are not used in LLC opinions
- Elements of the “Due Formation” opinion
 - The LLC has filed its certificate of formation which meets the minimum statutory requirements.
 - Has adopted a company agreement
 - Has at least one member
- Investigation
 - Review Certificate of formation & company agreement

- Validly Exists in Good Standing
 - Valid Existence is not a term used in the Delaware Act, it is actually a corporate term.
 - Elements of the Valid Existence opinion:
 - The certificate of formation which was filed and accepted by the Secretary of state meets the minimum requirements of the Act
 - The LLC has adopted a LLC agreement
 - The LLC has one or more members
 - [It has not commenced dissolution]
 - Has not filed a certificate of cancellation
 - Has not entered into a merger where it will be merged out of existence.

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- Validly Exists Cont'd
- Investigation:
 - Review “Filed” certificate or certified copy
 - Review company agreement
 - Certificate of good standing will disclose if a certificate of cancellation has been filed or the LLC was merged out of existence.
 - We obtain a certificate from the company:
 - Neither the Company nor the Member:
 - has commenced dissolution or liquidation,
 - has filed a certificate of cancellation nor has such been contemplated to be filed on behalf of the Company;
 - has not entered into an agreement of merger under which the company will be merged out of existence;
 - is not in liquidation, or subject to equivalent insolvency proceedings in any jurisdiction;
 - has had a receiver or manager appointed in relation to any of the Company’s assets;
 - has entered into any arrangement with its creditors or into any arrangement with its creditors that has not been concluded (as the case may be);
 - has caused application has been made to a court in another jurisdiction for the liquidation of the Company or the Member or for the Company or the Member to be subject to equivalent insolvency proceedings.

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- Validly Exists Cont'd
- Mistakes in the certificate of formation:
 - “substantial compliance” is sufficient
- Good Standing can only be determined from the records maintained by the Secretary of State
- Not a “legal opinion” per se
- Elements of good standing opinion:
 - Certificate filed meets the minimum statutory requirements
 - Taxes are paid
 - No certificate of cancellation has been filed
 - The company has not merged out of existence

Investigation: review good standing certificate

- Power and Authority
 - The Company has all necessary limited liability company power and authority to execute and deliver [the Transaction Documents], and to perform its obligations thereunder.
 - Elements of the Power and Authority opinion:
 - The activity is not prohibited under the Act (banking & insurance)
 - The certificate of formation does not limit the company's activities or powers
 - The activity is permitted under the company agreement's purpose clause, as it may have been amended
 - The persons acting on behalf of the LLC have been granted this authority to act under the company agreement or a resolution

Rendering Third-Party Legal Opinions on LLC Status, Power, Action, Enforceability and Membership Interests

- Power and Authority Cont'd
- Investigation
 - Review the company agreement
 - Determine from the company agreement or the resolution that the person or persons executing the transaction documents have been authorized to do so
 - If an entity is executing an agreement, review its organizational documents and obtain a resolution of that entity.

- **Due Authorization and Due Execution**
 - The execution and delivery of the Transaction Documents by the Company and the performance of its obligations thereunder have been duly authorized by all necessary limited liability company action by or on behalf of Company.
 - The shortened phrase “duly authorized” w/o “all limited liability company action” may imply governmental approvals.
 - Does not imply fiduciary duty compliance. (May want to include an assumption as to fiduciary duties)

- Elements of the “Due Authorization” opinion
 - Neither the certificate of formation nor the company agreement restrict the power or authority of the members, managers or other party who are executing the documents
 - The members, managers or other party executing the documents has complied with any procedural requirements in the certificate, the agreement or any delegation of authority adopted by the members or managers
 - There are no restrictions in the Act on the powers of the members, managers or other party executing the documents unless the restrictions have been complied with or waived.

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- Due Authorization Cont'd
- Investigation
 - Does the certificate or the agreement authorize or restrict the transaction
 - Does the certificate or agreement require and specific action by the members or managers such as a vote and if so was the vote taken
 - Review documentation as to such vote or votes
 - Does the LLC Act restrict the activity or require a specific vote
 - Obtain a Certificate:
 - Attached hereto as Exhibit A is a true and correct copy of the Borrower's Operating Agreement, which is in full force and effect as of the date hereof. Attached hereto as Exhibit B is a true and correct copy of the Borrower's Certificate of Formation. Attached hereto as Exhibit C is a true and correct copy of the Certificate of Good Standing, issued by the Secretary of State of the State of Delaware, Division of Corporations. Attached hereto as Exhibit D is a true and correct copy of the Resolution authorizing the Borrower to execute, acknowledge and deliver this Certificate, the Loan Documents and other documents in connection with the Loan, and other matters set forth therein. Attached hereto as Exhibit E is an Incumbency Certificate evidencing the authority of the Manager to execute all of the Loan Documents, as well as all other documents executed in connection with the Loan. The foregoing documents are the only documents created or governing the internal affairs of the Borrower, and the same have not been amended or modified except as stated in the Opinion Letter.

- Due Execution

- The Transaction Documents have been duly executed and delivered by the Company.

- Due execution includes the assumption that the signature is valid, it does not mean that a signature is authentic. Parties concerned about authenticity will rely on a notary's certificate.

Duly executed refers to the authorization of the member, manager or other party who have signed the documents on behalf of the company, the validity of the signature (often assumed other where in the opinion) and the incumbency of the person signing the agreement (often addressed in an incumbency certificate).

We include the following assumptions in our opinions:

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- (i) the legal competency of all individual signers of documents;
- (ii) that all signatures of the parties are genuine;
- **Due Delivery**
 - Due delivery means that the Company has physically (or at least “legally”) delivered the agreement to the other party or parties to the transaction to create a binding contract.
 - Investigation
 - Obtain a certificate from the Company

- Issuance of LLC Interests
 - “Limited Liability Company Interest” means a member’s share of the profits and losses of a limited liability company and a member’s right to receive distributions of the limited liability company’s assets. (6 Del. C. § 18-101 (8))

Opinions Given:

- “The limited liability company interest issued by the Company to the Purchaser has been validly issued.”
- “The limited liability company interest transferred by the Seller to the Purchaser was validly issued by the Company”

- Elements of the “validly issued” opinion.
 - LLC is validly existing
 - Opinion Giver Confirms:
 - that the creation and issuance of the LLC interest satisfied the requirements of the Act, certificate and agreement
 - that the issuance complies with:
 - Any conditions on issuance in the resolution or other action adopted under the agreement
 - Receipt of the kind and amount of consideration
 - the power of the LLC under the Act, certificate and agreement to create the interest covered by the opinion

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- that the LLC interests do not violate the Act, certificate or agreement
- Investigation:
 - Review Act (18-301 Admission of Members) (18-215 Series of Members ...)
 - Review certificate and agreement
 - Identify requirements of creating and issuing interests
 - Confirm that those requirements have been satisfied
- “Duly Authorized” “Fully Paid and Non-Assessable”
 - Duly authorized is a corporate concept
 - Corporation have authorized a pool of stock which may be issued
 - Generally LLC’s do not have pools of interests or a number of “units”

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- Fully Paid and Non-Assessable “ is likewise a corporate concept
 - Next speaker will deal with the obligations of the purchaser
 - Fully paid in the corporate context means that at least the “par value” or “stated value” has been paid and any additional consideration agreed to has been paid in full.
 - Non-Assessable means in the corporate context that the full consideration agreed to be paid has been paid
 - No comparable LLC concept
 - This is a commonly requested opinion but not an appropriate opinion to give

RENDERING THIRD-PARTY LEGAL OPINIONS ON LLC STATUS, POWER, ACTION, ENFORCEABILITY AND MEMBERSHIP INTERESTS

DRAFTING DEFENSIBLE OPINIONS AND MINIMIZING PREPARER LIABILITY RISK

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OPINIONS RELATED TO ADMISSION OF MEMBERS

1. Sample opinion language
2. Documents reviewed
3. Statutory review
4. Assumptions and other considerations

SAMPLE OPINION LANGUAGE

- Each of the Members has been duly admitted to the Company as a member of the Company.
- A Member shall not be obligated personally for any of the debts, obligations or liabilities of the Company, whether arising in contract, tort or otherwise, solely by reason of being a member of the Company, except as a Member may be obligated to make contributions to the Company and to repay any funds wrongfully distributed to it. A Member may be liable for its tortious or wrongful conduct and for its obligations as set forth in the Agreement.
- A Member will have no liability for any of the debts, obligations or liabilities of the Company solely by reason of being a member of the Company in excess of its obligations to make contributions to the Company, its obligations to make other payments provided for in the LLC Agreement, its obligations for tortuous conduct and its obligations to repay funds wrongfully distributed to it.

DOCUMENTS REVIEWED

- Certificate of Formation/Article of Organization
- Limited Liability Company Agreement
- Any other document governing admission or transfer (e.g. Subscription Agreements)

DOCUMENTS REVIEWED

- Review documents for provisions regarding admission to determine satisfaction of conditions and restrictions
 - examples include obligations to make payments, required consents, inclusion on books and records

STATUTORY REVIEW

- Review relevant LLC Act.
 - Under the Delaware Limited Liability Company Act, 6 Del. C. §18-101, et seq. (the “DE LLC Act”), there are two ways to purchase interests in an LLC:
 - Directly from the LLC
 - From another member

ADMISSION OF MEMBERS

§ 18-301 of the DE LLC Act: Admission of members.

(b) After the formation of a limited liability company, a person is admitted as a member of the limited liability company:

(1) In the case of a person who is not an assignee of a limited liability company interest, including a person acquiring a limited liability company interest directly from the limited liability company and a person to be admitted as a member of the limited liability company without acquiring a limited liability company interest in the limited liability company **at the time provided in and upon compliance with the limited liability company agreement or, if the limited liability company agreement does not so provide, upon the consent of all members and when the person's admission is reflected in the records of the limited liability company;**

(2) In the case of an assignee of a limited liability company interest, as provided in § 18-704(a) of this title and **at the time provided in and upon compliance with the limited liability company agreement or, if the limited liability company agreement does not so provide, when any such person's permitted admission is reflected in the records of the limited liability company**

ADMISSION OF PURCHASER OF AN LLC INTEREST FROM THE LLC

Under the DE LLC Act:

A purchaser of an interest in an LLC is admitted either:

- a. as provided in the LLC Agreement; or
- b. if the LLC Agreement is silent, upon the consent of all the members and when reflected on the books and records of the LLC.

ASSIGNEES

A party may also acquire an interest in the limited liability company from another member.

ASSIGNEES

§ 18-702 of the DE LLC Act

Assignment of limited liability company interest.

(a) A limited liability company interest is assignable in whole or in part except as provided in a limited liability company agreement. The assignee of a member's limited liability company interest shall have no right to participate in the management of the business and affairs of a limited liability company except as provided in a limited liability company agreement or, unless otherwise provided in the limited liability company agreement, upon the affirmative vote or written consent of all of the members of the limited liability company.

ADMISSION OF ASSIGNEES

Under the DE LLC Act, acquiring an LLC interest does not equate to obtaining membership in the LLC.

- Admission as a member is a separate event from acquiring an interest.

ADMISSION OF ASSIGNEES AS MEMBERS OF THE LLC

§ 18-702 Assignment of limited liability company interest.

- (b) Unless otherwise provided in a limited liability company agreement:
 - (1) An assignment of a limited liability company interest does not entitle the assignee to become or to exercise any rights or powers of a member;
 - (2) An assignment of a limited liability company interest entitles the assignee to share in such profits and losses, to receive such distribution or distributions, and to receive such allocation of income, gain, loss, deduction, or credit or similar item to which the assignor was entitled, to the extent assigned; and
 - (3) A member ceases to be a member and to have the power to exercise any rights or powers of a member upon assignment of all of the member's limited liability company interest. Unless otherwise provided in a limited liability company agreement, the pledge of, or granting of a security interest, lien or other encumbrance in or against, any or all of the limited liability company interest of a member shall not cause the member to cease to be a member or to have the power to exercise any rights or powers of a member.

ADMISSION OF ASSIGNEES AS MEMBERS OF THE LLC

§ 18-702 of the DE LLC Act

Assignment of limited liability company interest.

(d) Unless otherwise provided in a limited liability company agreement and except to the extent assumed by agreement, until an assignee of a limited liability company interest becomes a member, the assignee shall have no liability as a member solely as a result of the assignment.

ADMISSION OF ASSIGNEES AS MEMBERS OF THE LLC

Right of assignee to become a member

§ 18-704 of the DE LLC Act

- (a) An assignee of a limited liability company interest may become a member:
 - (1) As provided in the limited liability company agreement; or
 - (2) Unless otherwise provided in the limited liability company agreement, upon the affirmative vote or written consent of all of the members of the limited liability company.

ADMISSION OF ASSIGNEES AS MEMBERS OF THE LLC

Right of assignee to become a member § 18-704 of the DE LLC Act

(b) An assignee who has become a member has, to the extent assigned, the rights and powers, and is subject to the restrictions and liabilities, of a member under a limited liability company agreement and this chapter. Notwithstanding the foregoing, unless otherwise provided in a limited liability company agreement, an assignee who becomes a member is liable for the obligations of the assignor to make contributions as provided in § 18-502 of this title, but shall not be liable for the obligations of the assignor under subchapter VI of this chapter. However, the assignee is not obligated for liabilities, including the obligations of the assignor to make contributions as provided in § 18-502 of this title, unknown to the assignee at the time the assignee became a member and which could not be ascertained from a limited liability company agreement.

ADMISSION OF ASSIGNEES AS MEMBERS OF THE LLC

Right of assignee to become a member

§ 18-704 of the DE LLC Act

(c) Whether or not an assignee of a limited liability company interest becomes a member, the assignor is not released from liability to a limited liability company under subchapters V and VI of this chapter.

OBLIGATION OF PURCHASERS OF LLC INTERESTS TO MAKE PAYMENTS AND CONTRIBUTIONS TO THE LLC

Under DE LLC Act, obligation to make any payments or contributions upon admission is governed by the LLC Agreement.

- Delaware does not require any contribution.
- If a contribution is required, must be made for purchaser to be duly admitted.

OBLIGATION OF PURCHASERS OF LLC INTERESTS TO MAKE PAYMENTS AND CONTRIBUTIONS TO THE LLC

§ 18-301(d) of the DE LLC Act

(d) A person may be admitted to a limited liability company as a member of the limited liability company and may receive a limited liability company interest in the limited liability company without making a contribution or being obligated to make a contribution to the limited liability company. Unless otherwise provided in a limited liability company agreement, a person may be admitted to a limited liability company as a member of the limited liability company without acquiring a limited liability company interest in the limited liability company. Unless otherwise provided in a limited liability company agreement, a person may be admitted as the sole member of a limited liability company without making a contribution or being obligated to make a contribution to the limited liability company or without acquiring a limited liability company interest in the limited liability company.

PERSONAL LIABILITY OF PURCHASERS OF LLC INTERESTS TO THIRD PARTIES

- No obligation to third parties except:
 - Own tortious and wrongful behavior
 - Agreed to in the LLC Agreement or other relevant document

PERSONAL LIABILITY OF PURCHASERS OF LLC INTERESTS TO THIRD PARTIES

§ 18-303 of the DE LLC Act

Liability to third parties

(a) Except as otherwise provided by this chapter, the debts, obligations and liabilities of a limited liability company, whether arising in contract, tort or otherwise, shall be solely the debts, obligations and liabilities of the limited liability company, and no member or manager of a limited liability company shall be obligated personally for any such debt, obligation or liability of the limited liability company solely by reason of being a member or acting as a manager of the limited liability company.

(b) Notwithstanding the provisions of subsection (a) of this section, under a limited liability company agreement or under another agreement, a member or manager may agree to be obligated personally for any or all of the debts, obligations and liabilities of the limited liability company.

OPINION ASSUMPTIONS

- Many conditions to admission are beyond the scope of review of the opinion giver. Address with standard assumptions.

OPINION ASSUMPTIONS

Assumptions:

- that the managing member has taken all corporate action required to be taken by it to authorize the issuance and sale of units to the Members, and to authorize the admission to the Company of the Members as members of the Company
- the due authorization, execution and delivery to the managing member by each of the members of a subscription agreement
- the due acceptance by the managing member of a subscription agreement for each Member and the due acceptance by the Managing Member of the admission of the Members to the Company as members of the Company
- the payment by each Member to the Company of the full consideration due from it for the LLC interest acquired by it

OPINION ASSUMPTIONS (CONTINUED)

Assumptions:

- that the books and records of the Company set forth all information required by the LLC Agreement and LLC Act, including all information with respect to all persons to be admitted as members and their contributions to the Company
- that the books and records of the Company set forth the names and addresses of all Persons to be admitted as Members, the Capital Contributions of each Member, the agreed value of the Capital Contributions and all information required by the LLC Agreement,
- that the limited liability company interests in the Company are offered and sold to the Members in accordance with the LLC Agreement and the subscription agreement

SCOPE OF OPINION

Additional considerations:

- Limit definition of “Members” as used in the opinion to those members being admitted on the date thereof.
- Make sure you have considered all relevant documents addressing admission.
- “Other obligations as set forth in the LLC Agreement”

RENDERING THIRD-PARTY LEGAL OPINIONS ON LLC STATUS, POWER, ACTION, ENFORCEABILITY AND MEMBERSHIP INTERESTS

DRAFTING DEFENSIBLE OPINIONS AND MINIMIZING PREPARER LIABILITY RISK

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MINIMIZING PREPARER LIABILITY RISK

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THE SECRET TO PROTECTION FROM LIABILITY: THERE IS NO SECRET

The only “trick” to protecting yourself from liability as an opinion giver is to do the opinion correctly!

- Observe Rules of Professional Conduct
- Clearly State Assumptions, Reliances, and Carveouts
- Perform Necessary Due Diligence
- Follow Best Practices

APPLICABLE RULES OF PROFESSIONAL CONDUCT

Rule 2.3 Evaluation For Use By Third Persons

- (a) A lawyer may provide an evaluation of a matter affecting a client for the use of someone other than the client if the lawyer reasonably believes that making the evaluation is compatible with other aspects of the lawyer's relationship with the client.
- (b) When the lawyer knows or reasonably should know that the evaluation is likely to affect the client's interests materially and adversely, the lawyer shall not provide the evaluation unless the client gives informed consent.
- (c) Except as disclosure is authorized in connection with a report of an evaluation, information relating to the evaluation is otherwise protected by Rule 1.6.

APPLICABLE RULES OF PROFESSIONAL CONDUCT

Rule 1.6 Confidentiality Of Information

(a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).

(...)

(c) A lawyer shall make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client.

APPLICABLE RULES OF PROFESSIONAL CONDUCT

Rule 4.1 Truthfulness In Statements To Others

In the course of representing a client a lawyer shall not knowingly:

- (a) make a false statement of material fact or law to a third person; or
- (b) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.

LIABILITY OF OPINION GIVER TO CLIENT

Client may be liable for damages to lenders and/or servicers due in part to reliance on allegedly defective legal opinions.

In such cases, the client may have a case for malpractice against the opinion giver.

LIABILITY OF OPINION GIVER TO CLIENT

***Nomura Asset Capital Corp. v. Cadwalader, Wickersham & Taft LLP*, 115 A.D.3d 228, 236-237 (N.Y.A.D. 1st Dept. 2014) (internal quotations and citations omitted):**

- “To sustain a cause of action for legal malpractice, a plaintiff must show (1) that the attorney was negligent; (2) that such negligence was a proximate cause of [the] plaintiff’s losses; and (3) proof of actual damages.”
- “To show negligence, the plaintiff must establish that the attorney failed to exercise the ordinary reasonable skill and knowledge commonly possessed by a member of the legal profession.”
- “To establish proximate cause, the plaintiff is required to demonstrate that but for the attorney’s negligence, it would have prevailed in the underlying matter or would not have sustained any ascertainable damages.”

LIABILITY OF OPINION GIVER TO LENDER

- As opinion is rendered for the benefit of the lender and related parties, and lender makes the loan in reliance upon the opinion, an opinion giver is more likely to be sued by the lender in the event of a defective opinion.
- “A lawyer who makes a negligent misrepresentation in an opinion letter may be liable for any loss suffered by a person for whose benefit and guidance the lawyer intends to supply this misrepresentation or who the lawyer knows or reasonably should know will rely on the misrepresentation.” - Restatement (Second) of Torts, § 52

LIABILITY OF OPINION GIVER TO LENDER

Fortress Credit Corp. v. Dechert LLP, 2011 WL 5922969 (N.Y.A.D. 1st Dept.)

- No attorney-client relationship between opinion giver and lender.
- Lender is a nonclient, and there is no privity of contract between lender and opinion giver.
- However, Lender stands in “near privity” with opinion giver and may sue for negligent misrepresentation in the event it suffers harm due to its reliance on a defective opinion.

LIABILITY OF OPINION GIVER TO OTHER PARTIES

- Opinion givers should take reasonable steps to minimize potential plaintiffs.
- Prohibit addressees from disclosing the contents of the opinion to outside parties.
- Expressly restrict reliance by identifying who may rely upon the opinion. Typically includes:
 - Lender
 - Lender's successors and assigns
 - Loan participants (if applicable and distinguishable from assignees)
 - Services of the loan
 - Rating agencies
 - Their respective legal counsel

CLEARLY STATE ASSUMPTIONS, RELIANCES AND CARVEOUTS

[T]here are known knowns; there are things we know we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns – the ones we don't know we don't know. And if one looks throughout the history of our country and other free countries, it is the latter category that tend to be the difficult ones.

Donald Rumsfeld,
February 12, 2002



CLEARLY STATE ASSUMPTIONS, RELIANCES AND CARVEOUTS

Every affirmative statement made in the opinion letter must come from somewhere:

- Assumed fact
- Reliance on certificate from client
- Due diligence/Review of documentation

All carveouts and qualifications limiting the scope or applicability of the opinions generally (or of specific opinions set forth in the letter) should be expressly stated **with specificity**.

Documents reviewed should be specifically listed, and express statements included to the effect that no other document has been reviewed.

CLEARLY STATE ASSUMPTIONS, RELIANCES AND CARVEOUTS

- Reliance must be reasonable!
- Reliance on a public document (such as a Certificate of Formation) that clearly deviates in form from the standard form of such documents may not be reasonable, even if the lender accepts its validity/accuracy.

BEST PRACTICES

In general, best practices include steps that formalize the review process for opinion letters:

- Provide education for opinion givers to ensure competence in the areas opined upon.
- Increase redundancy and review by multiple attorneys prior to release/issuance.
- Establish opinions committee with oversight over custom and practice.
- Prepare approved forms for the opinion and require approval for substantial deviation from form.

BEST PRACTICES

Pros:

- Multiple reviewers increase the chances that mistakes will be caught.
- Standardized forms and formal requirements minimize chance for nonstandard and possibly deficient opinions to be issued.

BEST PRACTICES

Cons:

- More review increases costs.
- May not be feasible for small firms or practice groups.