Third-Party Legal Opinions
in Corporate Transactions

Defining Scope, Limitations and Key Terms; Minimizing Liability Risks for Opinion Giver

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1pm Eastern   |   12pm Central   |   11am Mountain   |   10am Pacific

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Third-Party Legal Opinions in Corporate Transactions

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Outline of program

• What is the context of legal opinions
  o Key components of opinion letter
  o Sources of guidance
• What are the sources of liability
• What are risk mitigation steps
  o Diligence
  o Internal review procedures
  o Opinion protective provisions
• Reliance on customary practice
• Insurance:
  o Claim experience
  o Insurance coverage alternatives
  o Insurer oversight
Context of Third-Party Legal Opinions

• Third-party opinions are statements of professional judgment regarding specified legal matters
  - They are not guaranties of a particular result
• Opinion satisfies condition to closing of other party to transaction
Different approaches to opinion practice

• Reliance on customary practice
  o Customary diligence
  o Customary usage
• Contract-based approach
  o Accord
• Tailored opinions v. “kitchen sink” approach
• Cost-benefit analysis
Legal judgments

• Laws covered
  o Jurisdictions
  o Substantive law
Factual predicates

• Diligence
• Reliance
• Assumptions
• Relevance of “knowledge”
Typical opinions - general

- Status and power of entity
- Requisite actions for authorization
- Remedies opinion - enforceability
- All necessary approvals obtained
- No violation of law
- No breach or default
- No-litigation confirmation
Typical opinions - transaction specific

- Capitalization
- Issuance of interests in entity
- Security interests and other property rights
- Securities law compliance
- Investment company status
- Usury and margin rules
Exceptions, qualifications and limitations

- General exceptions understood without being stated - bankruptcy, equitable principles
- Express assumptions
- Qualified opinions
- No misleading opinions
- Procedural/risk mitigation provisions
Sources of guidance

• Bar reports
  o ABA
  o TriBar
  o State bars
  o Multiple groups
• Legal Opinion Resource Center - http://apps.americanbar.org/buslaw/tribar/
• WGLO materials
• Treatises
• *Restatement (Third) of the Law Governing Lawyers* §§ 51, 52 and 95
Sources of liability - own client

• Malpractice
  o Duty owed to own client
  o Typically based on negligence
  o Not basis of claim to non-client (third-party opinion letter)

• Fiduciary duty
  o Duty owed to own client
  o Not owed to third party recipient of opinion letter
Sources of liability - third party: misrepresentation

• Misrepresentation
  o Typical basis of claim brought by non-client (third-party opinion letter)
  o Usually based on alleged negligence of opinion giver
  o *Fortress*
Sources of liability - third party: misrepresentation - elements

• Negligence
  o Assembling facts
  o Research and analysis of law
• Reasonable or justifiable reliance by opinion recipient
• Damages caused by reliance
• Contributory fault?
Sources of liability - third party: misrepresentation

• Liability for omissions?
  o Related to opinions given?
  o Unrelated to opinions given?
  o Misleading opinion risk
Sources of liability - third party: misrepresentation

• Role of customary practice
  ○ Discussed below
Sources of liability - third party: misrepresentation

- Role of ethical obligations
  - Ethics rules on conduct during negotiations
  - General ethical duties
  - Giving opinions under the law of another state
    - Competence test
Sources of liability - third party: misrepresentation

• Sources
  o *Restatement of the Law of Lawyers*
  o *Restatement of the Law Third Torts: Liability for Economic Harm (drafts)*
Due Diligence in General

- What is realistic for the size, cost, client relationship and time
- What is the best reliable source of information
- What is customary practice - scope and nature of the work counsel is expected to perform are based on customary practice of lawyers who regularly give, and lawyers who regularly advise opinion recipients regarding, opinions of the kind involved. (ABA Principles, § I B)
Reliance

- Factual representations and warranties in documents
- Public certificates
- Officer’s certificates
- No actual knowledge to contrary or reason to believe factual representation is not true
- Except public certificates, rely only as to facts, cannot rely as to ultimate legal conclusion
Assumptions

• Can be used to narrow the scope of due diligence where agreed to by the opinion recipient
  o May not mislead the opinion recipient
• Assumptions customarily used when facts lie outside lawyer’s expertise or otherwise not readily subject to investigation:
  o capacity of natural persons
  o authenticity of documents
  o conformity of copies to originals
  o genuineness of signatures
  o fairness of consideration
  o title to assets
  o authority of parties lawyer does not represent
Customary Due Diligence for Specific Opinions - status of corporations

• Corporate Status (how status is expressed determines due diligence inquiry)

• Duly organized - obtain good standing certificate and docketing list, Charter and all amendments, certified by secretary of state; review corporate statute that existed at the time of organization for compliance; may include reviewing advertising; will include review of organizational minutes.

• Duly incorporated - review corporate statute that existed at time of incorporation for compliance, good standing and docketing list, Charter and all amendments certified by secretary of state.

• Validly subsisting (PA) or validly existing and in good standing (Delaware) - review current charter and subsistence or good standing certificate from secretary of state.
Customary due diligence - status of other legal entities

- Review organic documents and statute under which formed to determine scope of additional due diligence, state filing requirements and applicability of good standing certificates
- Obtain certificate from appropriate person that organic documents reviewed are true, complete and correct and have not been amended or modified, either orally or in writing. Pay attention to broad statutory definitions of what is included as organic document.
- Apply corporate inquiry by analogy, but in addressing power and authority under operating agreement, partnership agreement or declaration of trust, you are covering contract law of the state in which the entity is formed
Customary due diligence - power

• Review law, resolutions and articles and bylaws or other organic documents

• Limit power to corporate power, partnership power or other organization power
Customary due diligence - authority

- Resolutions, articles and bylaws or other organic documents
- Incumbency certificate certified by appropriate officer or other authorized person
Customary due diligence - execution and delivery

- Verify authorized persons execute
- Make sure any legal requirements are met (i.e. president or some other officer required to execute)
- See or verify delivery
Customary due diligence - no breach or default of agreements or violation of court orders

- Limit the universe to agreements and court orders listed
- Review the agreements and court orders to confirm that the transaction being opined upon and the documents being opined upon do not cause a breach or default under the agreements reviewed
Customary due diligence - no violation of law

• In reviewing the documents being opined upon, be alert to provisions that may violate applicable law
• Understood to exclude local law
• Different from enforceability opinion
Enforceability

- Means that each and every agreement is enforceable in accordance with its terms unless an exception is taken.
- Bankruptcy and equitable principles exceptions will cover many of the normal enforceability exceptions.
- However, in reviewing the documents, one must always keep in mind that an opinion will be given as to the enforceability of each provision.
- Provisions can often be drafted to remove enforceability problems (e.g., “To the extent permitted by law, . . .”).
- Otherwise consider whether an assumption or exception needs to be included.
Approvals and filings

• Generally understood not to include local law
• What approvals and filings are required to permit:
  o execution and delivery and,
  o to extent covered, performance of documents being opined upon
Litigation confirmation

• Define “knowledge” (if used)
• Each person who is within the definition of knowledge must confirm that they have no actual knowledge of any litigation other than that described
Stock Issuance

• Duly authorized
  o Covers creation of class of stock (either in charter or manner provided in charter) and authority to issue shares of that class. Review corporate law, charter and resolutions of both board and shareholders

• Validly issued
  o Review corporate law and required board, committee and shareholders resolutions, charter and bylaws
  o Confirm legally sufficient consideration received
  o Confirm availability of sufficient authorized shares or treasury shares; any required regulatory approvals (e.g., public utilities)

• Fully paid
  o Consideration required by resolution or other corporate action received in full by company; satisfied requirements of law, charter and bylaws.

• Nonassessable - review corporate law and charter
Internal Review

- Two partner review
- Two partner review plus experts in areas covered such as UCC, tax, ERISA
- Opinion committee
Opinion protective provisions

• Customary
• Opinion speaks as of its date
• Covered law
• Limit reliance parties
Assumptions and exceptions

• Discussed in literature
• Specify law governing opinion
• Designate exclusive forum for resolution of disputes
• Limit persons who can sue (in addition to limiting reliance parties)
• Waiver of jury trial
• Limit time to bring suit
• Limit liability standard
• Disclaim certain bases for liability - i.e. consequential damages
• Indemnification from client
Role of customary practice

• Role of customary practice
  o Statement of Customary Practice
  o Project on common opinion practices
Role of customary practice - shield or sword (or both)?

- Role of customary practice
  - Establishing scope of opinion giver’s obligations?
  - Establishing scope of opinion recipients reasonable expectations?
    - Obligations of recipient’s counsel
Customary practice - how to identify

- Restatements
  - State bar reports
  - Actions of lawyers experienced in transactions of the type
Customary practice - national or local?

- Look to state where opinion giver primarily practices?
- Expectations of opinion recipient?
- Intra-state transactions
- National transactions
- International transactions
Insurance Considerations

• Virtually all law firms carry professional indemnity insurance
• All such coverage is on a “claims made” basis
• Usually one year policies
• The policy in effect when the opinion is delivered unlikely to be the policy that is in play on a claim on that opinion
Scope of policy

• Far broader than “malpractice insurance”
• Typical insuring clause covers any ACT “in [the ASSURED’s or the Firm’s] professional capacity as attorney
• Definition of ACT normally quite broad and would normally include “any act, error or omission (whether of acts, facts, law or otherwise), breach of contract for professional services, breach of duty, ...” (or words of similar import)
• Distinction between malpractice and broader wording is particularly important in opinion context
  o substantially all claims against firms and their lawyers on opinions are not malpractice claims but are brought by opinion recipients as negligent misrepresentation claims
Exclusions to consider

• Fraud or dishonesty
• Managed enterprise
• Fines and penalties
Retentions and Limits

• R-T-C one-time reinstatements
• Remember defense costs very high
• How much is enough?
• Gap between transaction sizes and limits
• Feeding the plaintiff?
What do underwriters ask about opinion practice?

• Generally reluctant to purport to advise firms how to practice law
• Likely want to know whether the firm has a two partner review practice
• May well want to know whether the firm has a functioning opinion committee
• Unlikely to delve too much deeper
• Volunteering the implementation of best practices can be useful
Sources of Large, Publicly Reported Claims

• 62 publicly reported settlements judgments since 1987 over $20 Million (exclusive of defense costs)
  o 41 dishonest clients (66%)
  o 10 conflicts
  o 4 combos (e.g., mistake/conflict)
  o 3 mistakes
  o 2 malicious prosecutions
  o 1 dishonest lawyer
  o 1 dishonest firm

• Dishonest clients a somewhat lesser factor (14 of 57, or 25%) in the $$$3-19 Million range
A dishonest client in an opinion case is a very potent mix

- *Fortress* decision perhaps over-proves the point
- *Grecas* and *Dean Foods* are more common illustrations of an opinion giver being drawn into a regrettable position by a dissembling client