

Report on Legal Opinion Risk Seminar II

The second Legal Opinion Risk Seminar II (LORS II) was held in April. Like LORS I, this was an invitation only seminar sponsored jointly by the American Bar Association, the TriBar Legal Opinion Committee, the Legal Opinion Committees of several major commercial states and law firms.

The program included panel discussions followed by break-out sessions. John Power requested that various attendees prepare brief reports of the various panels and break-out sessions. These reports are included in this newsletter. Thanks to John, Jerome Grossman, Morris Hirsch and Steve Hazen for their assistance.

Before the first panel discussions, Steve Weise gave an update on the Proposed Statement on Customary Practice. He has received comments from several state bars, and others have already signed on to the statement subject to reviewing any changes. There was an afternoon concurrent panel on the proposed statement. The morning panel discussion topics were: The Attorney-Client Privilege and Opinion Attorneys, Factual Opinions, Rationalization of State Bar Reports with ABA and TriBar Reports, Rationalization of Real Estate Reports with ABA and TriBar Reports, and Rating Agency Opinions. The morning panel discussion topics were: Responsibility and Concerns of Opinion Recipients and Their Counsel and Anatomy of a Claim. Thereafter, three concurrent break-out sessions were held to topics from LORS I in greater depth. The morning concurrent sessions included: Local Counsel opinions, Foreign Counsel opinions and Recipients and Opinions. Following the break-out sessions, participants reconvened for two additional panel discussions on Proposed Statement on Customary Practice, Sonic Blues - Some Lessons and Risk Analysis.

The participants reconvened for a report on each of the morning and afternoon concurrent break-out sessions. Formal written reports will be collected and published in due course. Included in this newsletter are short initial reports on the Assignable Opinions and Rationalization of Real Estate Reports with ABA and TriBar Reports. We hope to have reports for the remaining panels and break-out sessions ready for the next newsletter.

LORS plans to hold two meetings each year, the next to be held in the Fall, also in New York. If you are interested in participating and have supervisory responsibilities for legal opinions within your firm or organization, please contact Robert Rupp at the ABA at Ruppr@staff.abanet.org regarding becoming a member. The annual registration fee is \$2000 and will include attendance at the two meetings and materials. The fee is to help defray the cost of hiring staff to assist a working group that will take over responsibility for future LORS seminars.

Reports from LORS II

I. PROGRAMS

PROPOSED STATEMENT ON CUSTOMARY PRACTICE

In a presentation to all in attendance, followed by a breakout session for those who chose to attend, Steven Weise led a discussion of a proposed joint statement being presented to bar association committees that have issued legal opinion reports or have legal opinion subcommittees for their approval. The proposed report is designed to confirm that customary practice (customary diligence and customary usage) applies to third-party legal opinions. The statement is intended to provide assistance to those engaged in litigation over legal opinions (including attorneys, judges and juries) by directing them to customary practice in order to understand legal opinions, the legal opinion process, and the responsibilities of parties involved in that process.

ATTORNEY-CLIENT PRIVILEGE

This panel explored the complex issues relating to attorney client privilege and work product protection where litigation against an opinion giver is possible, imminent, threatened, or in process. It covered issues with protection of internal verbal, email and written conversations within the law firm before and after the opinion is rendered, notes, discussions with the firm's client, and conversations with and notice to the insurance carrier (including any claim coverage dispute). The discussion also covered potential responsibilities that may be in conflict with privilege and protection, e.g., duties of disclosure to the client and federal securities law disclosure requirements. Many firms designate one or more partners as counsel to the firm or general counsel, in part in an effort to protect conversations with these partners. Lawyers aware of possible problems with opinions they worked on were encouraged to talk with the designated partner or partners (and generally no others) in order to avoid the appearance of concealment but at the same time preserve the possibility of protection.

FACTUAL OPINIONS

This panel focused on statements in closing opinions that are intended to be purely or largely factual in nature and thus not actually "legal opinions." Panelists addressed no litigation statements, no breach or default statements, statements of non-existence of options or other matters that impact capital structure, and negative assurance statements as to the content of disclosure documents. The thrust of the presentation was to demonstrate that developments in opinion practice could result in complete elimination of the need for the use of "knowledge qualifiers" in most closing opinions, as proposed in The Boston Streamlined Opinion (available at 61 Bus. Law. 389 (November 2005)). The panel was in agreement that movement in that direction would be a significant improvement in opinion practice, in light of uncertainty as to the meaning of phrases like "to our knowledge."

A lack of clear analysis of the reasons for differences in practice in requesting negative assurance statements was noted. Steven Hazen discussed a provocative article he wrote for the seminar on this subject. Many commentators suggest that one criterion for a request for this statement is a collaboration of the opinion recipient and the opinion giver and its client in preparing and refining the disclosure document to which it relates. It appears that efforts to expand the situations in which these statements are given have generally been unsuccessful, based on the experience of the panel.

RATIONALIZATION OF STATE BAR REPORTS WITH ABA AND TRIBAR REPORTS

This panel reviewed reports issued by the ABA, the TriBar Opinion Committee and the state bars of California, Pennsylvania, Texas and Arizona with respect to certain issues to develop a better understanding of the degree to which different bar groups across the country are—or are not—converging on a single, national approach to third party opinion practice. Illustrative issues included (i) endorsement of “customary practice” as the relevant standard for interpreting third party legal opinions, (ii) endorsement of the “Golden Rule”; (iii) the “each and every” vs. “essential provisions” approach to the meaning of the remedies opinion; (iv) proscriptions against the delivery of misleading opinions; (v) recognition that a legal opinion is not a guaranty; (vi) appropriate reliance on sources of fact; and (vii) the scope of the “knowledge” qualifier. The panel found that broad consensus existed with respect to some of the issues—notably, customary practice, application of the Golden Rule, and legal opinions as expressions of professional judgment rather than guaranties—but that, while there appeared to be convergence with respect to other issues, not all of the reports used terminology sufficiently similar to that of other reports to allow the panel to conclude that the reports adopted the same standard. The panel noted that some of the differences could be attributed to the age of some of the reports, and that the current consensus with respect to the issues in question may be greater than is apparent from the reports themselves. Moreover, a number of bar groups are in the process of updating their reports, which could be expected to clarify the extent of convergence.

RATIONALIZATION OF REAL ESTATE REPORTS WITH ABA AND TRIBAR REPORTS

This panel explored why there are differences in the real estate reports and what are the differences.

The real estate reports focus principally on the remedies opinion. When the numerous qualifications to an enforceability opinion that addresses each and every provision of the documents are factored in, the question of what the remedies opinion really means becomes apparent. Because of the questionable enforceability of many provisions included in mortgages, leases, lease assignments and other real estate documents, the reports focus on how the opinion givers can move away from a laundry list of exceptions. The result is a qualification that moves away from the practical realization qualification to a generic qualification that focuses on whether the remedies are such that the opinion recipient would receive the basic benefits of those remedies. ACREL attempted to craft an assurance with more certainty focusing on the principal benefits of the real estate documents, including payment of principal and interest and foreclosure of the liens.

If a real estate remedies opinion includes the bankruptcy exception, the equitable principles limitation and the generic qualification, the panel saw little need to also include a laundry list. However, as a practice pointer, they did indicate that if the law of the state covered by the opinion had unusual remedies provisions, such as confession of judgment clauses, opinion givers in multi-jurisdiction transactions might want to call attention to those provisions. Furthermore, an opinion recipient could always request specific assurance concerning the enforceability of a specific provision, such as a prepayment penalty.

RATING AGENCY OPINIONS

This panel, which included representatives of two rating agencies, focused on closing opinions delivered to rating agencies and others in structured finance transactions, including the “true sale” opinion and the “nonconsolidation” opinion. It was noted that it can be significant to rating agencies whether there is a party to the transaction reviewing and receiving an opinion they are receiving. Although rating agencies do not consider themselves to be parties to or participants in the transaction, they are concerned about the integrity of the structure of the transaction. There may be a need for further conversations with opinion givers generally about the kinds of opinions that can or should be given to address that concern. There was agreement that increasing complexity of structured finance will amplify pressures to clarify and publicize customary legal opinion practice on what opinions should be requested. Perhaps customary practice for rating agency opinions and for opinions given to others is or will be different.

The panel also discussed the overlap between legal issues covered in opinions to parties and rating agencies in structured finance transactions, and issues considered by auditors in reviewing accounting treatment of the transaction. Rating agencies and accountants are not necessarily addressing the same issues. It is important to develop wider understanding of differences in customary practice that exist or should exist as between opinions to rating agencies and to accountants.

ASSIGNABLE OPINIONS

This panel focused mainly on the issue of assignability of borrowers’ counsel opinions in syndicated loan transactions. Market participants (borrowers, agent banks, syndicate members and secondary market sellers and buyers) have a strong interest in facilitating loan assignability, thus improving liquidity and spreading credit risk. Assignability, however, exposes the opinion giver to the risk of multiple suits in multiple jurisdictions governed by different laws. Also, assignees may not be familiar with customary practice and may differ from the initial recipients in ways that are relevant to the opinion.

Various theories of assignee reliance on (or benefit of) opinions were discussed, together with relevant market practices.

Various approaches to entitling assignees to the benefits of borrowers’ counsel opinions were discussed, including:

1. Addressing the opinion only to the agent bank on behalf of the lenders, with suit on the opinion brought only by the agent bank upon a vote of the lenders. While novel, the panelists saw much merit in this approach.

2. The Wachovia/Latham & Watkins assignability provision, which permits assignment to permitted assignees under the credit agreement, subject to various express limitations based on the ABA Principles and Guidelines. This approach appears to be gaining acceptance.

3. Limiting assignments to a relatively short period of time, intended to cover the primary syndication but not secondary trading. While some opinion givers have been using this approach, it is increasingly opposed by loan syndicators (including money center banks), due to its potential adverse effect on syndications and loan trading.

SIDE LETTERS

This panel described various types of side letters, e.g., side letters only with main parties, side letters with one or some parties and side letters with one or more non-parties. Reasons for side letters include secrecy and efficiency (too cumbersome to cover in main agreements). Side letters can supplement the main agreements (e.g., permitting more or less time for an act or notice), change terms for one or more parties with no effect on others (e.g., management fees), change terms for some with incidental effect on others (exclusion from some partnership contributions), or change terms for some with substantive effect on the rights of others. Counsel might be asked to opine on side letters, and frequently is asked to opine on the main agreements, where the impact of the side letters on the main deal and its main agreements could be important. The presence of side letters may raise issues in rendering opinions on authority, remedies and limited liability.

One question is whether side letters amend the main agreements. In many cases partnership agreements have “enabling” provisions which permit alteration of terms by side letters. The panel felt that that these enabling provisions do not render partnerships agreements illusory because of the fiduciary duties of the parties and the implied covenant of good faith and fair dealing. In the fund formation area, fund participants are often permitted to avail themselves of side letters entered into by the sponsor after the fact, by “most-favored nation” arrangements.

Counsel rendering opinions on the main agreements want to review all side letters, and typically require a certificate that they have seen all side letters. Local counsel and recipient counsel typically also want to be sure they have seen all side letters.

II. BREAKOUT SESSIONS

LOCAL COUNSEL

This session discussed such issues as the relationship between local counsel and (1) lead counsel, (2) the opinion recipient and its counsel, and (3) the client. It also covered issues for local counsel, including limited information, limited time, and limited fees.

FOREIGN COUNSEL

This session discussed the usefulness of preparing a checklist or guidelines for use by counsel requesting opinions by non-U.S. counsel. It also dealt with the circumstances in which the opinion recipient should rely on its own non-U.S. counsel in relation to foreign issues.

RECIPIENTS

This breakout session continued the discussion of recipient issues begun at LORS I. It returned to the question whether recipient counsel has a responsibility to the opinion giver to understand customary practice, and it was agreed that that duty is not owed to the opinion giver. But recipient counsel probably does have a responsibility to advise its client that it does not understand customary practice. Where neither the recipient or its counsel understand customary practice, there is the risk that they do not understand the meaning of and diligence for the opinion. There was also a more general discussion of the desirability of advising recipient clients when recipient counsel does not understand the meaning of opinions being received, for example opinions from foreign counsel.

There was a difference of view on whether the opinion giver is safe in relying upon customary practice in giving its opinion where the opinion giver recognizes that the opinion recipient and its counsel do not understand customary practice. Possible solutions include discussing customary practice with the recipient, providing it a memorandum that explains key aspects of customary practice, or stating expressly in the opinion that it is given in accordance with customary practice (or in accordance with the ABA Principles which incorporate customary practice). A representative of a major institutional opinion recipient said that he would not accept an opinion that states it is governed by customary practice, even though he understands that opinions are generally governed by customary practice.

There was a discussion of a technique used in some complex transactions with multiple parties (e.g., investors), some of which are not represented by counsel. Special counsel “to the transaction” is engaged to represent the interests of these parties, including reviewing opinions.

SONIC BLUES – SOME LESSONS

This session discussed a recent California bankruptcy case in which an opinion giver was disqualified from representing its client in a subsequent Chapter 11 proceeding when a

claim was made on its pre-petition opinion given on behalf of the client, and inadequate or untimely disclosures of the claim were made to the bankruptcy court.

RISK ANALYSIS

This session discussed liability and ethical risks of opinion givers, including risks of getting the facts or law wrong, the risks of representing dishonest or incompetent clients, and the risks of real or perceived conflicts of interest. It also discussed steps that can be taken to minimize these risks.

Spring Meeting Report

The committee met for approximately one-half hour to discuss the proposed customary practice report that had been circulate prior to the meeting. Steve Weise introduced the report and indicated that the intent was to lay a foundation for having courts apply customary practice when faced with opinion litigation. The report does not break new ground, rather it seeks to take the basis for customary practice from the Restatement of the Law Governing Lawyers and provide it in a plain English, readily accessible format. The report does not attempt to define customary practice - that is defined in bar reports and will be established by expert testimony.

We were not in a position to accept the report at our meeting, because several members felt there had not been sufficient time to review and comment on the report. We will devote additional time to the report at the Annual Meeting in San Francisco in August. If you are unable to attend, please forward any questions or comments to me and I will forward them to Steve Weise. We hope to be in a position to approve the final report in August.

LORS I, which was described in the December newsletter was the focus of our committee forum, which followed the meeting. The final agenda for LORS I and the break out reports are available at the Legal Opinion Resource Center.

Arthur Field introduced the LORS concept, which is to provide a forum for sophisticated opinion givers and opinion recipients to discuss opinion issues, and in appropriate cases, to provide position papers. The participants are not limited to opinion givers, but include representatives from institutions who are major opinion recipients, rating agencies, liability insurers and representatives of many state bar associations.

After the introduction, Lori Gordon from ALAS spoke about the types of opinion claims she sees. She often finds juries are forgiving of mistakes, so long as there is no appearance of a conflict and thus divided loyalty. The biggest risk to law firms is the bad client, either a crook or a clown, who engages in a failed transaction with significant amounts of other people's money. Don Glazer followed with some do's and don'ts following the identification of a potential claim, the most important being to speak, not write or email, to your firm's general counsel or loss prevention partner.

John Power briefly discussed issues identified at LORS with respect to duties of opinion recipients, and Carolan Berkley described the assignable opinion breakout session.

The materials are available on the ABA website, and if you attended the Spring Meeting, but could not make our program, there is an audio file available.
