Chapter 9

Characteristic
Third-Party Opinions

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In general, the opinion preparer has only a limited duty to investigate. In most cases, the representation of an appropriate client officer provides a sufficient factual basis for an opinion. But, what if the opinion preparer knows facts that raise questions about client representations? Similar questions are raised if the opinion preparer knows facts that make reliance on assumptions questionable.

Two recent cases highlight the danger faced by opinion preparers in evaluating information they have or should have. In *Dean Foods Co. v. Pappathanasi*, the opinion preparer relied on a client representation that no litigation or investigation was pending, although the law firm knew of a criminal investigation of a customer. The law firm had investigated the client’s involvement in the potential criminal matter and knew that it could be implicated under certain realistic circumstances. This is discussed in section 9:6.4.

In *Alderstein v. Wertheimer*, the directors knew that the controlling shareholder, who was also a director, did not have an opportunity to use his power to dismiss directors. The directors acted without prior notice to the controlling shareholder and issued stock that would divest the controlling shareholder of control. They did this to avoid insolvency. The court invalidated the stock issuance on the theory that the directors could not participate in a scheme to deprive the controlling shareholder of his rights, even if their motives were not self-serving. A claim was filed against the opinion giver. This is discussed in section 9:6.4.

In each case, the opinion preparer was faulted, because he knew enough to require action prior to giving an opinion [further investigation in *Dean Foods*; an opportunity to remove directors in *Alderstein*]. The *Dean Foods* and *Alderstein* cases raise difficult questions for opinion preparers. See also section 13:13 as to “Fraud and Opinions.”

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3. *See Anchel v. Shea*, 762 A.2d 346 (2000), a Pennsylvania Superior Court case, which took a different view of facts somewhat similar to those in *Alderstein*. 
§ 9:1 The Three-Set Opinion Pattern

In most business transactions, three sets of opinions are requested. They deal with:

a. identifying the characteristics of the party about which the opinion is sought;

b. the transaction involved and the documentation used in the transaction; and

c. the promises and property exchanged at closing.

The opinions requested about the party usually relate to: (a) corporate or other entity status; and (b) claims and litigation. The claims and litigation opinion may bridge the party opinions and the

HANDLING EXCLUDED OPINIONS

Assume that an opinion request is for information about claims asserted in writing. The opinion preparer is aware that an entirely credible and very substantial claim has been asserted orally. Further assume that the opinion request is also for information about investigations involving the client. The opinion preparer is aware of a current investigation of a customer of the client that raises the possibility of such an investigation of the client. What position should the opinion preparer take? Is the information a “red flag” that requires more investigation? Is a technical approach that the opinion does not cover the information justified under the circumstances? If a technical position cannot be taken, how will the opinion preparer be able to define his or her areas of responsibility?

Opinion giving is not a game. Opinion preparers cannot ignore relevant, sensitive material that comes to them on the theory that the opinion letter language excludes the material. The opinion preparer must consider how to treat the material so that the opinion letter will be fair to the recipient.

If the opinion preparer obtains relevant sensitive material, even as to an area stated to be clearly excluded from the opinion, the opinion preparer must consider the possibility of non-opinion problems. Even if a judge or jury adopts the view that there is no responsibility in the opinion situation to disclose information as to areas not covered by the opinion letter, the failure to disclose may give rise to a charge of conspiracy, aiding and abetting, or fraud. The matter not disclosed may involve an agreement misrepresentation by the client. If it does, and if it is knowing, the client may be sued and the opinion recipient may see the opinion preparer as aiding in a knowing misrepresentation.
transaction opinions (see below), since they may cover claims and litigation, if any, related to the party as well as those related to the transaction.

The opinions requested about the transaction usually are that:

a. it is not in contravention of law in the pertinent jurisdictions;

b. it does not violate other agreements binding the party;

c. it does not require some governmental authorization or approval that has not been obtained;

d. it is not in contravention of the certificate of incorporation or bylaws (or other entity documentation); and

e. it is within the power of the entity and is authorized by it.

The opinions requested about the promises and property exchanged at closing can involve a wide variety of subjects, such as:

a. if an Agreement (such as a credit agreement) will govern the conduct of the parties in the future, a remedies opinion is requested;

b. if the transaction involves the delivery of real property at the closing, a title opinion as to the property is requested; and

c. if there is an issuance of stock, an opinion as to the status of the stock is requested.

Opinion letter requests should ask for no more than is needed to address the legitimate concerns of the opinion recipient. As discussed in several places in this treatise, opinion requests should not violate the “Golden Rule.” See section 3:3.5

§ 9:2 Identifying and Defining the Party Whose Status Is at Issue

Hidden within the more substantive opinion questions about an entity is a simple but very important one. An opinion about an entity, no matter how learned, is not of much use if the indemnification of the entity is wrong. Thus, the opinion preparer needs to question management about the proper name of each entity involved in a transaction. Sometimes the transaction planning has not reached a stage at which the entity to be used has been formed. Sometimes entity names are changed in connection with a transaction. Often entities within a group use similar names. Thus, an initial and important task for the opinion preparer is to verify the name of the entities to be involved in the transaction.
Opinion requests sometimes include affiliated entities. Including affiliates in an opinion letter request may dramatically increase the work involved in giving the opinion letter. It may be satisfactory to the recipient to limit opinions to specific affiliates. Those affiliates chosen are likely to be the entities that have substantial assets or are directly related to the transaction. It would definitely be important to the opinion preparer and to completing the closing on schedule.

**ENTITY FORMATION**

Until recently, the entity choice for most business transactions was the corporation. But, the number of Delaware limited liability companies now exceeds the number of Delaware corporations. Opinions about Delaware limited liability companies are now quite common. While the TriBar II report assumed that the entities involved were corporations, a 2006 TriBar report focuses on how to give limited liability company opinions. *See Closing Opinions: Limited Liability Companies, 61 Bus. Law. 679 (2006).* TriBar is working on a supplemental report on limited liability companies.

The TriBar II advice (at footnote 106) was that non-corporate entity opinions might be handled by analogy to corporate opinions. This analogy is helpful but, like most analogies, has its limitations. In addition, all non-corporate entities do not present the same formation questions.

There is usually no question when a corporation is incorporated. It is when the certificate of incorporation is filed with the state Secretary of State. A certificate of limited partnership can be filed only if a partnership agreement exists. That agreement, taken with applicable statutory provisions, will cover governance.

By contrast, the certificate of formation of a limited liability company can be filed before a limited liability company [operating] agreement is adopted. Thus, the limited liability company does not have governance or sharing provisions as a result of the certificate being filed. The Delaware Limited Liability Company Act requires the existence of a limited liability company agreement for the “formation” to be completed. *See Chapter 18, § 18-201(d)* of the Delaware Limited Liability Company Act.
§ 9:3 Opinions as to Entity Status

There are three different types of opinions about corporate status that most institutional opinion recipients tend to request:  

a. valid existence; and either  
b. due incorporation (or formation); or  
c. due organization.

Due incorporation (or formation) and due organization are historical opinions. They tell the recipient that in the past an entity was incorporated (or “formed,” the term usually applicable to non-corporate entities) in compliance with the law applicable at that time. The opinion preparer’s task is to ascertain that all requirements of the statute for incorporation or formation have been satisfied.

While it is usual to rely on governmental agency certificates even as to legal conclusions, incorporation and formation is an exception to the rule. The opinion preparer cannot rely on the certificate as to incorporation or formation. The only value of the certificate is establishing the state of the public record. See TriBar II, section 5:13 and footnote 47, attached as Appendix C.

No opinion recipient is concerned only with what was. Therefore, the opinion as to status is coupled with an opinion that brings the status opinion up to date. That opinion is usually a “valid existence” opinion. It relates to the current date and is based upon a certificate of the state Secretary of State to that effect.  

A characteristic corporate status opinion is as follows:

The Borrower is a corporation duly incorporated [organized], validly existing . . . . See TriBar II, section 6.1.1, attached as Appendix C, for a full discussion of the “Duly Incorporated” opinion.

The opinion preparer cannot establish due incorporation without obtaining information (ordinarily in certificate form from the Secretary of State of the applicable jurisdiction) as to the status of the

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5. In New York, the certificate states that the corporation is “validly subsisting.” In Delaware, the certificate uses the language “validly existing.” Sometimes, a valid-existence opinion is acceptable to a recipient, even in the absence of a due-organization or incorporation opinion. When rendering a valid existence opinion without an incorporation opinion, it is customary to review a certified copy of the certificate of incorporation in addition to the secretary of state certificate. See Tribar II, § 6.1.3(b) attached as Appendix C, infra.
public records. While such a certificate dated years ago can establish incorporation, only a currently dated certificate can establish that the entity remains alive. Certain trusts and general partnerships can be formed without a public filing. However, most entities cannot be formed without a public filing.

THE SIGNIFICANCE OF STATUS OPINIONS

What is the result of an entity not being validly incorporated, organized, “formed,” or existing? In most situations, those which hold themselves out as having entity [that is, limited liability] status will be held by the courts to have such status, at least for the purposes of the transactions involved. If the formation defect is not substantial, the entity should be accorded de facto status in any court proceeding, although it has not achieved de jure status. If it is not accorded de facto status, those who purported to utilize the entity would likely be held individually liable as partners or joint venturers. In such a case, recourse to those involved, if they do not each have limited liability status, may be more valuable to a claimant than if the entity had been validly formed.

Any defense to a claim based solely upon the failure of an entity to deal properly with its internal governance is likely to be given short shrift by the courts. Why then worry about these opinions? To some extent, the business community judges the competence of those it deals with by whether they have been able to deal with formalities such as these. Is a group that cannot properly establish its own formation likely to comply with complex covenants in loan documents? And perhaps more importantly, the questions raised can be the source of troublesome litigation between those involved within the entity. If the entity is not properly formed, the principals may not be able to assert that as a defense, but others may be able to assert individual liability against the principals. The third party who requests the opinion does not want to become enmeshed in such litigation, nor does it desire the individuals or entities involved to be spending its (or their) time and resources in such activity. The purchaser of equity in an entity will want its status to be clear. The concern is that, if the entity is not properly formed, the purchaser may have a claim but not an equity interest.

6. See N.Y. Tax Law, art. 9, and § 203-a[1], (3). Corporations delinquent in taxes for two years may be dissolved by proclamation of the Secretary of State. See Del. Code Ann. tit. 8, § 510, pursuant to which the corporate charter may be rendered void for non-payment of taxes for one year.
Legal Opinions in Business Transactions

§ 9:3.1 Incorporated Status, Organization, and Valid Existence

“Organization” comprehends (a) incorporation and (b) action after incorporation to permit proper commencement of corporate activities. Thus, it deals with actions under corporate laws only. It does not include obtaining permits, licenses, or the like that may be a prerequisite to opening the doors of a new business. The “valid existence” opinion confirms that entitlement to corporate status continues up to the date of the opinion.

The incorporation opinion as well as the conclusion that appropriate action under the corporation laws was taken to allow commencement of corporate activity are historical opinions. That is, the opinions relate to an earlier time and therefore to law applicable then. Compliance with current law is not responsive to these opinion questions. On the other hand, the valid existence opinion is determined under current law.

7. When an “organization” opinion is obtained, there is no reason to obtain a separate incorporation opinion. The organization opinion clearly includes incorporation. The usual objection to an opinion by implication—the possibility that the lawyer giving the opinion will not understand its full meaning—is absent. There is little reason for an opinion preparer to resist giving an “organization” opinion as to a newly incorporated entity. The relevant facts are easily available, often in the opinion preparer’s office. However, organization opinions as to long-established entities are usually not cost-justified.

8. If the third party has received a satisfactory opinion as to these questions in the past (whether or not from the same counsel), consideration may be given to waiving these opinions. This assumes that the counsel who gave the opinions was satisfactory (for the earlier transaction) to the third party. However, note that the third party is not entitled to rely on the earlier opinion as to this transaction; the opinion relates to another transaction. The third party may nevertheless regard the earlier opinion as sufficient diligence on the question to justify a waiver.
[A] Incorporation

The filing of a certificate of incorporation with the appropriate state recording officer usually gives rise to a presumption of proper incorporation. Presumptions are normally rebuttable. A lawyer giving an opinion on incorporation cannot rely on a presumption that is rebuttable, even if it is only rebuttable by a state official, who ordinarily has little interest in rebutting incorporation.

Because the presumption is usually a rebuttable one, the opinion preparer will ordinarily need to determine, without reliance on the presumption, that there was proper incorporation under the law applicable at the time of incorporation. The opinion preparer will begin the diligence for this opinion by obtaining a certified copy of the certificate of incorporation, directly or through a service company, from the state filing officer. Receipt of such a copy provides a starting point. It is only from this document (which will ordinarily indicate the filing or other applicable incorporation date) that the lawyer can determine the date of incorporation and thereby determine the law applicable at the time of incorporation.

Requirements for forming the corporation are set forth in the corporation statute effective at the time of incorporation. The opinion preparer will examine these requirements. The certificate of incorporation will satisfy some of them. An example is a statement of the date of formation of the corporation and the number of its authorized shares. It will be more difficult to deal with other requirements.

The age of the incorporators will always be a question. Even if the certificate were to state that the incorporators were “of age,” how, years later, would the opinion preparer know this to be true? How does the opinion preparer verify that the requisite number of incorporators signed? One person might have forged five names. The lawyer is entitled to rely on the standard assumptions applicable to the review of documents: (a) that the signers are of age, and (b) that the signatures are genuine. The second assumption is broader than it looks at first. It allows the lawyer to assume that the signers all existed and that their signatures are the ones on the document.

9. See, e.g., N.Y. BUS. CORP. LAW § 403, which permits the attorney general alone to avoid the presumption, which is otherwise stated to be “conclusive.”

10. This can be a painstaking job. Many lawyers maintain careful file memos to form the basis for subsequent incorporation and organization opinions on behalf of the corporation in question.

11. Reliance on a client-certified copy of the certificate of incorporation is not appropriate.

12. See section 5:17, supra.
There are cases that support the effectiveness of a defective certificate of incorporation. But, the case authority is often not specific enough to support an opinion that determines that the defect is so minor that it will not affect corporate status.

[B] Organization Requirements for Commencing Corporate Activity

The law has not dealt as directly with the requirements for commencing corporate activity as it has with incorporation. There is no filing with any governmental agency to evidence the completion of corporate organization. “Formation of corporations” is covered by a separate Article of the Business Corporation Law in New York, and all of the requirements for incorporation will be found there.

The requirements for commencing corporate activity are scattered and subtle. The lawyer must determine these requirements and confirm that they have been met. Only when the corporation has completed all the formal requisites for commencing corporate activity will it be “duly organized.” All of this is made more difficult, because the opinion preparer will likely need to determine the requirements under a prior law, and determine whether they had been met years before.

The concept of “due organization” relates only to the power of a corporation to take corporate action under applicable corporation laws. It does not signify that a corporation has met all legal requirements to commence business or that it is properly licensed to undertake the activity for which it was organized.

[C] Valid Existence and the Continued Entitlement to Entity Status

Incorporation tells us only about the past—that there was once an entity. The opinions that the “Borrower is a corporation” and that it is “validly existing” cover present corporate status.

The opinion as to incorporation is merely a way-station on the road to the opinions on organization (if applicable) and valid exist-

13. See, e.g., N.Y. BUS. CORP. LAW § 404 as to organization meetings, N.Y. BUS. CORP. LAW § 504 as to consideration and payment for shares, and N.Y. BUS. CORP. LAW § 601 as to initial bylaws. This list is not exhaustive. These are the current requirements. Those applicable are the requirements at the time of organization.

14. A lawyer giving an incorporation or organization opinion may wish to preserve the factual materials supporting the opinion. These materials are helpful, if any question is raised as to the basis for the opinion. Also, the materials are likely to be useful in later opinions on the same subject for the same corporation.
The opinion recipient is concerned with entity status and the ability to utilize it at the time of the opinion.

Like incorporation or formation, termination of entity status is quite formal. Thus, termination by dissolution, merger, or other transaction is and has been covered specifically in the statutory law. Governmental filings are and have been required to terminate entity status. Consequently, diligence begins with a search of governmental filing office records to see if any procedure has been undertaken to terminate the entity’s existence, whether by the entity or the state.

A corporation continues to validly exist, even though it has started formal action to terminate its existence. For example, it may be appropriate to file a notice of intent to dissolve to put tax authorities on notice. Such a notice will not terminate the valid existence. Similarly, valid existence is not terminated by a mere tax delinquency or some other basis for dissolution of the corporation under the applicable statute.

Only when action has actually been taken by the state to dissolve, and such action is completed, will the status as a corporation be terminated. But, a lawyer who discovers that voluntary or involuntary dissolution has commenced, must determine whether an unqualified opinion as to valid existence would mislead the opinion recipient, if there has been no disclosure of the action taken to begin dissolution proceedings.

**[D] LLC and Other Non-Corporate Entity Opinions**

The popularity of limited liability companies over the last decade has brought attention to opinions about the formation of limited liability companies and other non-corporate entities. TriBar II at footnote 106 suggests that corporate opinions may be applicable by analogy to non-corporate opinions. The TriBar Report—Third-Party Closing Opinions: Limited Liability Companies, 61 Bus. Law. 679 (2006), attached as Appendix L, goes further and establishes a pattern for customary practice in giving such opinions.

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15. See, e.g., N.Y. BUS. CORP. LAW art. 9, dealing with Merger or Consolidation, and arts. 10 and 11, dealing with Judicial and Non-Judicial Dissolution.

16. Sole reliance on a certificate from the corporation that the state has not taken such action is not appropriate. See section 5:10, supra. Such a certificate may be useful, however, to supplement any search of government files.
§ 9:3.2 Legal Opinions in Business Transactions

§ 9:3.2 Good Standing and Qualification to Do Business

[A] State Taxation Enforcement

In order to obtain reports and tax revenues from entities operating in a state, each state requires that entities formed in the state remain in “good standing.” Entities formed outside the state are required to qualify to do business there and to maintain that qualification. To evidence such qualification and the continuation of it through reporting and tax payments, qualification certificates are available from state authorities.

To evidence compliance by entities formed in the state with reporting and tax responsibility, good standing certificates are available. A failure to remain qualified may result in, among other things, a loss of access to the state court system as a plaintiff. A similar failure by entities that are formed in the state may result in state efforts to dissolve the entity to enforce payment, but the tax authorities are more likely to proceed directly against the corporation or its assets.

[B] The Key Significance of the Certificates Themselves

The terms “qualified to do business” and “good standing” have no accepted meaning apart from the state certificates issued to evidence such status. Lawyers’ opinions on these questions are usually given based solely upon the appropriate state certificate. The certificate, and thus the opinion, means no more than that the state agency involved has not determined that the entity is so delinquent that it will refuse to issue the certificate in question.

In some jurisdictions, certificates of good standing or their equivalent are not available. Sometimes only a tax certificate is available. In these circumstances, good-standing opinions should indicate that they are based solely on the tax certificate.

17. In New York, two certificates, one as to “subsistence” obtained from the state Secretary of State and the other as to “tax status” obtained from the State Tax Commission, are together regarded as the “good standing” certificate. Some opinion recipients will find such certificates acceptable as a substitute for an opinion.

18. In some jurisdictions, two different agencies are involved.
[C] Formulating the “Doing Business” Opinion Request

Opinion preparers are sometimes faced with the request to provide an opinion to the effect that the entity has qualified to do business wherever its property or business activities require qualification. Such an opinion goes far beyond a review of certificates. The opinion requires an analysis by the opinion preparer of the client’s property and the client’s business, as well as an analysis of state “doing-business” requirements for each state affected by the property and business. Because the analysis is so factually oriented, it is time-consuming. Such broad requests provide a more complete and thus a theoretically “better” legal answer. But, their extravagant cost and the likelihood that conclusions will remain unclear typically makes them undesirable as a business matter.

Further, few opinion preparers have sufficient experience with the administration of state “doing-business” requirements to take a position regarding the need to qualify. Therefore, a request for a comprehensive, doing-business opinion is ordinarily not appropriate.

If the broad formulation described above is not appropriate, how should an opinion request as to qualification to do business be formulated? One normally looks at:

a. the states from which the bulk of the revenues of the entity are derived;
b. the states in which the entity owns or leases real property or has employees, offices or inventories; and
c. some or all other states as to which there is substantial contact.

Particular attention needs to be given to states in which a failure to qualify cannot be fully cured. From the foregoing list, a selection based upon relative risk is often made, rather than requiring certificates as to all jurisdictions as to which there is any contact.

An opinion as to whether an entity is qualified to “do business” in a particular jurisdiction is a relatively easy one, so long as evi-

21. The risk is highest where, because of a failure to qualify, access to the courts is permanently barred regarding an entity’s existing claim. Can the suit be brought elsewhere? The more usual risk is of taxes, interest, and penalties due to a jurisdiction regarding which qualification is found to have been required.
dence of qualification from governmental authorities is available. That is because it is usual to give opinions and to receive them solely in reliance upon certificates of governmental authorities as to qualification and good standing, even when the lawyer is not admitted in the states from which the certificates are obtained.22

§ 9:4 Claims Including Litigation

Quite often opinions are requested and given as to claims. A comprehensive form is as follows:

To the best of our knowledge, after due inquiry, there are no pending or overtly threatened actions or proceedings affecting the Borrower or any of its properties before any court, governmental agency or arbitrator that purport to affect the legality, validity, binding effect or enforceability of the Loan Agreement or any of the Notes which, individually or collectively with other such pending or overtly threatened actions or proceedings arising or purporting to arise out of the same or similar facts or circumstances, may materially, adversely affect the Borrower’s financial condition or operations.

This form of opinion includes matters that will not be within the knowledge of the typical lawyer handling a transaction, since it covers litigation and claims whether or not related to the transaction. This comprehensive form includes litigation but also includes matters not pending before any tribunal. The mere threat of an action voiced by the claimant is clearly included. The opinion covers: (a) claims going to the validity of the transaction at hand; and (b) claims going to the borrower’s financial condition or operations.

A knowledge limitation is often seen in this opinion. The existence of claims is a factual question. Consequently, the opinion preparer will usually rely on the certificate of a corporate officer regarding the facts involved. The “knowledge limitation” is not effective to restrict the opinion. It merely draws attention to the opinion’s essentially factual nature.

The opinion form above adds “after due inquiry” after the knowledge exception. This is more a matter of style than substance. One cannot give this opinion without making some level of inquiry. The opinion has no meaning, unless a company-officer certificate representation or some similar factual basis exists to support it.

22. See TriBar II, §§ 6.1.4 and 6.1.6, attached as Appendix C, infra.
§ 9:4.1 Claims and the Corporate Due Diligence System

Opinions about claims are heavily influenced by the procedures established through the American Bar Association for lawyers to respond to audit inquiries about their clients. Business entities engaged in complex transactions have their financial statements audited annually by independent accountants. In connection with these audits, the business entities maintain an internal information system as to claims against them. This system facilitates the handling of their accountants’ annual inquiries connected with reviewing the entity’s financial statements.23

Since 1975 lawyers have been responding to audit inquiries as to claim against their clients in accordance with an ABA Statement of Policy.24 These inquiries relate to claims handled by that lawyer or law firm for the client. Only rarely will the lawyer be in a position to conclude that the likelihood of an unfavorable outcome is probable or remote. Only these two conclusions are sanctioned by the ABA Statement. Thus, in the vast majority of cases, the information provided is about the existence of a claim, but the claim is not evaluated.

An opinion giver delivering a claims opinion should follow the same approach taken in answering an audit inquiry. It would make little sense for a lawyer working on an unrelated transaction to provide a more detailed analysis of a claim or litigation than the analysis provided by lawyers working on the matter and thus charged with greater diligence. Therefore, the usual claims and litigation opinion is no more than a list of the claims and litigation matters reduced to fit within a definition of materiality (for example, excluding claims of less than $5,000) acceptable to the parties.25 The opinion is likely to be no more than a repetition of the certificate of a corporate officer.

Why bother with an opinion that merely identifies the existence of claims? Institutional clients find significant comfort in knowing that an opinion preparer has reviewed the certificate of the corporate officer, who may not be a lawyer. The principal advantage of that review is likely to be in: [a] a better recognition of what constitutes a claim; and [b] the quality of the description of the claims.

§ 9:4.2  

LEGAL OPINIONS IN BUSINESS TRANSACTIONS

In recent years, in many situations, the opinion given on litigation or on claims is limited to those affecting the transaction as to which the opinion letter is given. See section 9:4.2 below.

§ 9:4.2 Litigation or Claims Concerning the Transaction

An opinion covering any litigation or claims concerning the validity and enforceability of the transaction is usually required, in addition to the overall claims opinion. The opinion will normally not evaluate the claim (in accordance with the ABA Statement of Policy), but will explain it. If there is any such claim, the party receiving the opinion will likely obtain its principal guidance from its own counsel. In most transactions, the Agreement that governs will provide an option to the opinion recipient to withdraw from the transaction, if there are any such claims or litigation.

§ 9:4.3 No-Investigation Opinions

Sometimes the litigation or claims opinion is expanded to include “investigations.” That is a broader area and may benefit from a definition so that everyone agrees on what constitutes “investigations.”

The Dean Foods case26 held that the opinion giver was liable for not disclosing a pending, criminal investigation in an opinion on a sale of a business. The opinion giver knew that a customer of the client was being investigated for a fraud that might involve the client. Nevertheless, the opinion giver relied on a client representation without further investigation. When the opinion preparer knows that a client representation may be unreliable, the opinion preparer’s choices are to: (a) withhold the opinion; or (b) investigate and establish the reliability of the representation.27

§ 9:5 Handling “Materiality” as an Opinion Term

Quite often opinion givers are asked to opine that there is no pending or threatened action that may materially, adversely affect the financial condition or operations of the client corporation. How are opinion preparers to judge what may materially affect the client’s financial condition or operations?

While there is ample precedent for materiality opinions, there is limited learning as to how to give them. There are some easy cases

27. See note preceding section 9:1, supra.
on the extremes (for example, a “slip and fall” that does not involve permanent injury). In the absence of an easy case, however, the “safe” approach is to opine only as to material contracts and to define materiality in the opinion itself. An example is “Claims of less than $2.5 million in the aggregate are deemed immaterial.”

Opinion givers sometimes decline to deliver materiality opinions, because no standard can be agreed upon. In the absence of guidance regarding the definition of materiality, many opinion preparers will feel obligated to include in the opinion all claims as potentially material.

§ 9:6 Opinions About the Transaction

§ 9:6.1 Contravention of Law

The opinion preparer must determine whether the proposed transaction violates federal or state law (including regulations). The limitation as to the law covered will limit this opinion to the state law specified in it.

The unavailability of an unqualified contravention-of-law opinion does not mean that an unqualified remedies opinion cannot be given. A transaction may violate the law but still be valid. If the transaction is not invalidated by a violation of law, the remedies opinion will not be affected by the violation. In such a case, the recipient of the opinion will know of the violation only because of the contravention-of-law opinion.

A typical form of a non-contravention opinion is:

The execution, delivery, and performance by the Borrower of the Credit Agreement and the Notes . . . (iii) do not contravene . . . any law, rule, or regulation applicable to the Borrower [including, without limitation, Regulation X of the Board of Governors of the Federal Reserve System].

The ABA Guidelines disapprove of “comprehensive legal compliance opinions.” The opinion above is not a comprehensive legal compliance opinion, because it is limited to matters related to the transaction.

28. See ABA Guidelines II, § 3.2, attached as Appendix A, infra.
29. Contra-vention-of-law opinion requests that relate to all activities of the borrower, rather than to the transaction, are ordinarily not appropriate. See ABA Guidelines II, § 4.3, attached as Appendix A, infra.
§ 9:6.2 Breach of Other Agreements

Assume that the borrower has agreed with Lender A not to borrow more than $X in addition to the borrowings from Lender A. Nevertheless, the borrower is about to enter into an additional loan agreement with Lender C that contemplates an immediate borrowing of more than $X. That borrowing will cause the borrower to be in violation of its covenant to Lender A. Lender C will normally require the following opinion when its loan is funded:

The execution, delivery and performance by the Borrower of the Loan Agreement and the Notes . . . do not contravene . . . any contractual . . . restrictions contained in any document listed in the Certificates or, to the best of our knowledge, contained in any other similar document.

Why does Lender C care? At the most simplistic level, Lender C does not want to deal with a borrower that is unconcerned about its obligations. In addition, Lender C knows that, if the borrower is in default to Lender A (as a result of the loan by Lender C), the borrower may be subject to a variety of “cross default” provisions in other agreements, which will put the borrower in default to many others as well. The borrower may thereby complicate and possibly seriously prejudice its ability to conduct its business. Lender C will also be concerned about possible liability to Lender A on the theory that Lender C has tortiously interfered with Lender A’s loan agreement.

Another risk is highlighted by Kelly v. Central Hanover Bank & Trust Co.32 It suggests that knowingly taking collateral in violation of an existing security interest may result in loss of the new security interest.

This opinion is a particularly important one, because in many cases the fact that the agreement with Lender A will be violated by a loan under the Lender C loan arrangement will not preclude counsel to the borrower from issuing an unqualified remedies opinion at the closing of the loan from Lender C. Ordinarily, in such a situation, the borrower will be bound by its agreement with Lender C, just as it is bound by its agreement with Lender A. Thus, the unqualified remedies opinion may be justified, even in the face of an impending

31. Many lenders require that their loan documents include a provision making a default to another lender a default to themselves. Such provisions allow a lender, which has not experienced a default, to utilize the default to another lender as a basis for accelerating its debt.

default. Only by asking for the violation-of-other-agreements opinion can the recipient be certain that this important question has been addressed.

How does the opinion preparer know what agreements to review to determine if they are violated by the contemplated agreement? The lawyer will rely on a certificate of a client-officer as to other agreements. It is not practical for the opinion preparer to read all other agreements of an entity to give this opinion. Not many agreements of most companies purport to restrict their activities. Ordinarily, the administration of such agreements will be specially handled by inside counsel, the corporate secretary (or the equivalent), or a financial officer. The responsible officer will prepare the certificate and provide the relevant agreements to the opinion preparer.

If the responsible officer is a lawyer, an opinion, instead of a certificate as to facts, can be given. In choosing whether to have an opinion by inside or outside counsel, one weighs the efficacy of the “fresh look” of the outside lawyer against the expertise of an inside lawyer, who has followed the specific subject matter for some time.

§ 9:6.3 Governmental Approvals

A typical opinion involving government approvals is the following:

No authorization, approval, or other action by, and no notice to or filing with, any governmental authority or regulatory body is required for the due execution, delivery, and performance by the Borrower of the Credit Agreement or the Notes [except for . . . all of which have been duly obtained or made and are in full force and effect].

Compare this opinion to the “no contravention of law” opinion in section 9:6.1. The opinion above is clearly within the ambit of the opinion in section 9:6.1. A failure to obtain a required govern-

33. Query whether disclosure is required to meet fair presentation requirements. See section 3:8, supra.
34. Reliance on an opinion should be indicated in the opinion of the relying lawyer. The lawyer would be justified in relying upon a certificate as to the relevant facts, regarding which there would ordinarily be no mention in the opinion. See section 5:10, supra, as to reliance on officers’ certificates as to matters of fact. It is not appropriate for a lawyer to rely on a certificate stating that the agreements are the only ones that may bear upon the transaction at hand. Reliance on them would avoid having the lawyer determine whether the inquiry was sufficient to give an opinion on the subject.
mental approval will mean that the entry into the transaction contravenes the law. Why require this redundant opinion? The opinion is required only because it draws attention to the need to consider whether regulatory approvals or filings are required prior to closing.

An opinion preparer needs to review carefully whether regulatory approvals are required, either because of one or more of the entity’s other business activities (for example, banking or public utility) or because of the specific transaction contemplated. It will be easier for the opinion preparer to see when regulatory approval is required for a contemplated transaction. It will be more difficult for the opinion preparer to determine whether, within the overall affiliated group, there is some activity that is regulated. The regulatory regime may affect the group, although the company whose transaction is then being considered is not itself regulated.35

Ordinarily, the entity’s officers involved will understand and will be able to convey to the opinion preparer all available information about regulation of the entity and others in the affiliated group. The opinion preparer will research the law and seek certificates regarding the facts necessary to define the underlying opinion. The danger lies in a regulatory body that has jurisdiction, but that jurisdiction is not perceived by the officers. An example is status as an investment company under the Investment Company Act.

§ 9:6.4  Corporate Power and Authority

Entity power is derived from state law. One determines it by reading state law and the organizational documents. Authority is the exercise of that power. A typical opinion in this area is as follows:

The execution, delivery and performance by the Borrower of the Credit Agreement and the Notes are within the Borrower’s corporate powers, [and] have been duly authorized by all necessary corporate action.

The foregoing opinion is typical as to a corporation. It is shown here as it might be used in a lending transaction. An opinion for a joint-venture agreement would merely substitute the words “Joint-Venture Agreement” for “Credit Agreement and the Notes.”

35. It is not appropriate for a lawyer to rely upon a certificate that the corporation “is not engaged in any regulated business.” That would be a legal conclusion. See section 5:10, supra.
[A]  Corporate Power

A corporation may not have the “power” under state law to engage in a transaction, whether because of the form of the corporate charter or because of limitations of state law now or at the time of incorporation. If “power” is lacking, no authorization by the shareholders or directors to take the action can provide the “power.” An amendment to the corporation’s charter will ordinarily be required to cure a powers problem, if it can be cured.

In most situations, the corporation will not be able to use a lack of power or authority as a defense. But, the ultra vires doctrine is not as dead as some would like it to be. It may be asserted in shareholder suits and by state authorities. There may be situations in which the courts will not be willing to let the stockholders bear an unauthorized loss. Thus, it continues to make sense for those requesting opinions to verify the presence of corporate power.

[B]  Corporate Authorization and Fiduciary Duty

If there is corporate power, the lawyer must determine whether corporate “authorization” is present. This requires a determination of whether shareholder, director, or other action is required and whether it has been appropriately taken. Transactions in the ordinary course of business will need neither shareholder nor director authorization. Transactions that involve opinions, however, will seldom be seen as “in the ordinary course of business.”

Shareholder action requirements are normally statutory but may arise under the certificate of incorporation or bylaws. If it is

36. Similar power problems affect limited liability companies, partnerships and trusts.
37. If the form of charter restricts corporate activities to a stated purpose or group of purposes, the statutory powers provisions will not be read to expand the purposes clause. The powers will be read to relate only to the purposes stated.
38. Most corporation laws apply to all corporations of the state in question. See, e.g., N.Y. BUS. CORP. LAW § 103. Thus, ordinarily as to powers, one looks to the current corporation law rather than to the law applicable at the time of incorporation. But, the corporate charter may restrict the powers provided to those granted in the certificate or by former law.
39. There are situations in which the problem cannot be cured. For example, for many years, a corporation could not engage in the practice of law, and even now only professional corporations may do so.
40. See, e.g., N.Y. BUS. CORP. LAW § 203.
41. Id.
42. See, e.g., N.Y. BUS. CORP. LAW § 908, which requires a supervote of shareholders to authorize a guarantee not in furtherance of corporate purposes.
required, the lawyer must determine whether notice and the vote were proper.

Shareholder action can be costly and time-consuming. Thus, a determination of whether it is required is a threshold issue in many transactions. If shareholder action is not required, authorization by the board of directors will suffice. The lawyer must oversee or review the action by the directors. Such action is often taken by resolution at a meeting called and held in accordance with the bylaws, but sometimes it is taken by “consent”43 or by an executive committee of the board.44

An opinion preparer must determine that the board (or executive committee) was properly elected and convened and acted properly in giving its authorization.

An opinion preparer is ordinarily entitled to assume that there is no violation of fiduciary duty and that appropriate disclosures have been made without any statement in the opinion. It would be impractical in most situations to cover these issues in an opinion. But, no assumption may be used to mislead, nor may reliance be placed on an unstated assumption, if it is not reliable.45

43. See, e.g., N.Y. BUS. CORP. LAW § 708(b), which permits unanimous “consent” meetings of the board.
44. See, e.g., N.Y. BUS. CORP. LAW § 712. Note the peculiar requirements for the election of an executive committee—a vote by a majority of the entire board, rather than a majority of a quorum of the board.
45. See TriBar II, §§ 2.3(c) and 3.5.2(b).
FIDUCIARY DUTY

A recent Delaware Chancery case, *Alderstein v. Wertheimer*,<sup>46</sup> points out the difficulty of giving an authorization opinion. In the *Alderstein* case, the directors of a company whose stock was controlled by Mr. Alderstein used their authority to issue preferred stock that shifted control to a new investor. They did so in an attempt to obtain new capital that they in good faith believed was an immediate necessity to continue the business. They knew that Mr. Alderstein did not agree. The directors had been given the power to issue preferred stock in accordance with the DGCL. They acted at a meeting the controlling shareholder-director attended without prior notice of the action the other directors intended to take. The preferred stock was issued in accordance with the certificate of incorporation and the bylaws.

Nevertheless, the court invalidated the sale. The decision discussed concepts of fairness, rather than fiduciary duty. It is one thing to apply equitable principles to contract remedies. The application of somewhat similar ideas to authorization is less familiar and much more troublesome. Just as with equitable principles, fiduciary duty and fairness concepts are impossible to fully describe. Unlike the equitable principles area, however, fiduciary duty-fairness concepts can invalidate the agreement altogether.

The opinion preparer can assume (without disclosure) that there is no fiduciary duty-fairness problem, but only if there is none that has come to the opinion preparer’s attention.<sup>47</sup> In *Alderstein*, the other directors knew that the controlling shareholder was opposed to the action they intended to take. The judge saw that factor alone as enough to invalidate the transaction, because Mr. Alderstein had the power to remove the directors and, in the court’s judgment, did not get an opportunity to do so. The buyer knew that the controlling shareholder was opposed to the issuance of the stock, although the controlling shareholder-director did not dissent at the meeting. How should the opinion preparer approach these ambiguities? Once the opinion preparer knows that there is or may be a dispute as to authorization, an investigation should be made of those matters. There is no longer an entitlement to assume no violation of fiduciary duty.

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47. See TriBar II at § 3.5.2(6).

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Fiduciary duty concepts are developing. The analysis by the courts is not always satisfying. But, even if these concepts were fully developed, how would the opinion giver know if the fiduciary duties were satisfied? The opinion giver may know that such duties were not satisfied (for example, the Board voted without considering the relevant issues) but will seldom be able to come to an affirmative conclusion, since some issues may not be known (for example, personal interests). Thus, assumptions are usually justified. See section 5:16.

In Alderstein, the facts were known, although perhaps not the conclusion that fiduciary duty was violated. If the relevant facts are known, and the directors are held to have violated their fiduciary duty, can the lawyers be held to have participated in a conspiracy to do so or to have aided and abetted?

[C] Other Entity Power and Authority

Like opinions on entity status, custom as to non-corporate power and authority opinions are less clearly defined than corporate opinions. Limited partnership agreements and limited liability company agreements are contractual arrangements that provide a broad range of governance alternatives. Complexity is common and ambiguity may follow. Complex governance arrangements may make opinion giving on power and authority difficult. Note the expansive definition of limited liability company and limited partnership agreements under Delaware law.48

§ 9:6.5 No Conflict with the Certificate of Incorporation or Bylaws

A typical opinion on corporate power and authority is as follows:

The execution, delivery and performance by the Borrower of the Credit Agreement and the Notes . . . do not contravene [i] the Charter or the Bylaws [of Borrower] . . .

This opinion is ordinarily within the ambit of the opinion on corporate power and authority, which is also discussed in section 9:6.4. An Agreement that conflicts with the certificate of incorporation or the bylaws cannot be within the corporate power of the corporation, unless the provision in the certificate of incorporation or bylaws is not valid. Nevertheless, it is possible for an opinion preparer to conclude that despite, for example, a prohibition against the Agreement

in the bylaws, the corporate power opinion can be given, because for some reason the parties are estopped to deny corporate power. The question for the opinion preparer is whether disclosure is nevertheless required by this opinion, which goes to conflict rather than to the broader concept of power. In general, the opinion preparer will take the more conservative position and provide the necessary disclosure.

§ 9:6.6  Conflict with Non-Corporate Entity Governing Documents

Limited partnership and limited liability company Agreements can be quite complex. The Delaware limited liability company statute seems to incorporate Agreements (in addition to a formal limited liability company agreement): “written or oral . . . as to the affairs of a limited liability company and the conduct of its business.” Thus, the limited liability company Agreement may encompass more than the Agreement bearing that title. A similar definition affects limited partnership Agreements. Custom is still developing.

49.  Id.