Article

Report of the Committee on Corporations Regarding Legal Opinions in Business Transactions

Prepared by the Committee on Corporations of the Business Law Section of the State Bar of California

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I. PURPOSE OF THE REPORT

In recent years, articles have appeared in legal publications expres-

This Report is a commentary by members of the Committee on Corporations of the Business Law Section of the State Bar of California on the use of written opinions in business transactions, with particular consideration of the impact of California law on such opinions. It is not intended to prescribe standards of care, forms of legal opinions or procedures for rendering opinions. The views set forth reflect a consensus among the members of the Committee. The Report has not been considered of approved by the State Bar of California or by its Business Law Section.

I. PURPOSE OF THE REPORT

In recent years, articles have appeared in legal publications expres-
sing concern about the substance, form and proliferation of written legal opinions in business transactions. These concerns have focused on the usefulness of such opinions, the increased cost to clients participating in the underlying transaction and the liability exposure of lawyers resulting from such opinions.

This Report discusses the general understanding of what is meant by the term "legal opinion" in the business law context and the characteristics which distinguish these opinions from informal legal advice. The principal objective of the Report is to assist lawyers in the preparation of legal opinions by examining common formats for legal opinions and by identifying and discussing the meanings generally ascribed to certain terms and phrases commonly utilized in legal opinions. In those instances where language commonly found in legal opinions is reasonably subject to differing interpretations, this fact is noted. In addition to these general topics, the Report discusses:

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

2. The standard of care required under California law, with particular attention to the standard of care in rendering opinions in specialized areas of the law, such as tax and securities law. Unresolved issues regarding the standard of care are also noted, although the Committee emphasizes that the Report is not intended to establish an independent measure of the standard of care or to constitute evidence of the standard of care.

3. The nature and extent of the "due diligence" investigation a lawyer should undertake before issuing particular kinds of opinions, such as confirming factual information or assumptions which may be part of the opinion and determining what legal research is necessary.

Finally, the Report contains a glossary of terms used in legal opinions and a bibliography of articles on the subject.

II. DEFINITION AND PURPOSE OF A LEGAL OPINION

The term "legal opinion" has received varying definitions from commentators depending upon the context in which it is used. In the con-
text of business transactions, a legal opinion can be more accurately defined as a formal writing prepared by a lawyer, expressing the lawyer's informed understanding of the legal principles generally applicable to a specific transaction or applicable to a particular aspect of such a transaction.

Legal opinions in business transactions are frequently prepared either at the request of the lawyer's client in order to furnish the client with information regarding the probable legal consequences of a contemplated action or transaction. More commonly, they are prepared in order to satisfy a requirement to the transaction's closing which has been imposed through negotiation by the parties to the transaction and their counsel. A client may also request a formal legal opinion, not for the client's own guidance, but rather for delivery to a government agency or presentation to third parties, either directly or in a prospectus or annual financial report.  

The following are several of the more common reasons for the preparation and delivery of a legal opinion:

1. To provide assurance that an intended course of action is lawful or that certain acceptable legal consequences will follow from an intended course of action (or, conversely, that certain unacceptable legal consequences will not result from the proposed course of action);
2. To confirm that certain legal relationships exist or have been created;
3. To provide a warning to the recipient that there are certain legal risks in proceeding with the transaction;
4. To resolve disputes or uncertainties (e.g., an opinion expressed as to the meaning of particular language in a contract);
5. To satisfy contractual requirements (e.g., an opinion given by issuer's counsel pursuant to a stock purchase or bank loan agreement);
6. To satisfy regulatory requirements (e.g., an opinion given in connection with the qualification of securities under the California Corpo-

for his client, embodying his understanding of the law as applicable to a state of facts submitted to him for the purpose . . . ."

3. See Fuld, Legal Opinions in Business Transactions: An Attempt to Bring Some Order Out of Some Chaos, 28 Bus. Law 915 (1972). A common opinion of this type is the "tax shelter opinion" rendered by the lawyer to analyze the tax effects of a tax shelter offering. These opinions are currently the subject of considerable discussion because of certain abuses or perceived abuses, and the American Bar Association has published certain ethical guidelines for the preparation of these opinions. ABA Comm. on Ethics and Professional Responsibility, Formal Op. 346 (1982). The United States Treasury Department has proposed a rule which would require lawyers who provide tax opinions to comply with certain standards of due diligence, disclosure and judgmental determinations. Proposed amendment to Circular 230 (Department of the Treasury), 31 C.F.R. §§10.33, 10.51 and 10.52, 45 Fed. Reg. 58,594 (1980).

rate Securities Law of 1968 or their registration under the Securities Act of 1933);

7. To provide a basis upon which a regulatory body may rely in its own interpretation of a fact situation (e.g., an opinion relied on by the staff of the Securities and Exchange Commission in issuing a “no-action” letter);

8. To resolve a question raised by other professionals and to provide an authoritative basis for statements, reports and opinions with respect to matters on which other professionals are not competent to make judgments, or for which they are unwilling to assume responsibility (e.g., an opinion provided on local law for a general counsel); and

9. To provide a defense to allegations of wrongful conduct or assessment of penalties through reliance in good faith on an opinion of counsel.

III. LEGAL STANDARDS APPLICABLE TO PREPARATION OF AN OPINION

There is currently no case law or Bar canon that clearly articulates the standard of care imposed upon attorneys under California law in rendering opinions. Generally speaking, a lawyer is expected to be well informed and to exercise “such skill, prudence and diligence as lawyers of ordinary skill and capacity commonly possess and exercise in the performance of the tasks which they undertake.” In addition, a lawyer is expected to discover “rules of law which, although not commonly known, may readily be found by standard research techniques.” When a matter falls within a recognized area of legal specialty, a more stringent “prudent expert rule” is generally applied.

There is little case law that specifically involves errors in rendering legal opinions, but the same or similar legal standards no doubt apply.

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5. The canons of the ABA Code of Professional Responsibility are currently being amended and are only advisory with respect to California lawyers. For a list of California cases concerning the care and skill required of lawyers, see Appendix B. See also Dunlavey, "Legal Malpractice: The Standards of Care," 4 LOS ANGELES LAW., 34 (1982) (discussion of the California judicial authorities).


8. When a legal matter falls within an officially or commonly recognized legal specialty, the courts have imposed a duty on the general practitioner to refer the client to a specialist (or to recommend a specialist) “if under the circumstances a reasonably careful or skillful practitioner would do so.” Horne v. Peckham, 97 Cal. App. 3d 404, 414, 158 Cal. Rptr. 714, 720 (1979). Attorneys rendering advice with respect to matters falling within a recognized legal specialty have been judged by the standard of whether they possessed the knowledge and skill ordinarily possessed, and whether they exercised the care and skill ordinarily used, by a specialist in similar circumstances. Id.; see also Wright v. Williams, 47 Cal. App. 3d 802, 810, 121 Cal. Rptr. 194, 199 (1975). If due care is exercised in referring a client to a specialist, the referring attorney should have no liability as a result of the specialist’s negligent actions.
An attorney should afford ample time to research and interpret applicable legal principles, investigate the facts which underlie the opinion and identify areas of uncertainty, if any, in the interpretation and application of legal principles. Early research and investigation will also afford the attorney a greater opportunity to isolate potential problem areas and to negotiate an appropriate form of the opinion.

IV. PREPARATION OF THE OPINION

A. Preliminary Considerations

Before a legal opinion is rendered or requested in a particular business transaction, the lawyers representing principals in the transaction should carefully consider the size, nature and scope of the transaction and the relationship of significant legal issues to the transaction. Each lawyer should also consider whether the rendering of a particular opinion will create a conflict or inconsistency in the representation of existing clients. The lawyer also may consider the possible estoppel effect of any opinion which may preclude representation of other clients affected by the issues to be addressed by the opinion.

At the outset it should be noted that there are many business transactions, or elements of business transactions, that the lawyer should recognize as being inappropriate subjects for the rendering of a formal legal opinion. Generally, opinions are not requested or rendered on such matters as those concerning nonmaterial subsidiaries or liabilities, laws of other states or foreign countries or issues on which the opinion must be so qualified that it is of little value. This Report discusses several common instances in which it may be inappropriate to issue or request a particular form of legal opinion. An effective practice is for a lawyer to consider whether he or she would agree to furnish the opinion if requested to do so by another lawyer participating in the transaction.

B. Problem Areas and Inappropriate Subjects for Opinion

Differences between counsel generally arise over (1) the time and legal expense required to render an opinion on a peripheral matter that is legal in nature, (2) whether the opinion will cover matters that are essentially factual in nature, (3) matters in which there is some recognized legal uncertainty, and (4) requests for "comfort" opinions.

9. See infra notes 10-20 and accompanying text.
I. Opinions That Are Not Cost-Effective

As discussed in Part III of this Report, lawyers are held to a certain standard of skill and care in preparing and rendering legal opinions. Although the nature and extent of the applicable standard of care is not clearly defined, the lawyer is apparently obligated to research legal issues and perform some investigation of the facts upon which the opinion will be based.\(^\text{10}\) For this reason, the rendering of a legal opinion may be a costly process, even in the context of a relatively straightforward business transaction. In determining whether an opinion is appropriate under the circumstances, and, if so, what the nature and scope of that opinion should be, the lawyer must consider the costs which will be incurred by his or her client in rendering the opinion in relation to the benefits to be gained by the requesting party. In many cases the lawyer for the requesting party should be satisfied by his or her own review and advice, and refrain from requesting an opinion by the lawyer for another party to the transaction. Similarly, the lawyer requested to render an opinion requiring costly preparation should consider negotiating a more limited opinion in appropriate circumstances, such as when the issue is one involving only general legal principles but substantial factual investigation or involving legal principles not especially within the expertise of the opining lawyer.

In order to avoid unnecessary costs in preparing an opinion, the lawyer whose opinion is requested should carefully review the proposed draft opinion (usually prepared by opposing counsel) and resist acquiescence to provisions covering matters which, while having some importance to the recipient party, are peripheral to the transaction covered by the agreement. A not uncommon example is an opinion that the client “is not in material violation of any federal, state or local law, regulation or administrative ruling.” Such a representation constitutes a legal conclusion that may place an impossible burden on the attorney rendering the opinion.\(^\text{11}\) Normally, the time and financial resources of the parties and their counsel are better served by appropriate representations and warranties in the underlying agreement and by a full investigation designed to discover potential problem areas, rather than by placing an overbroad burden on a single attorney or law firm in the transaction.


\(^\text{11}\) For instance, a factual and legal investigation may be required into such diverse matters as employee benefit laws, health and safety laws, environmental regulations, antitrust laws and rezoning laws. With many substantial businesses, the possibilities may be virtually endless and well beyond both the competence of the particular lawyer or law firm involved and the pocketbook of the client.
Too often the burden is seemingly lessened by allowing the lawyer to base the opinion upon his or her "best knowledge" or "knowledge," phrases typically intended to imply that the lawyer has not engaged in any comprehensive factual or legal investigation whatsoever. Such qualifications have no generally accepted legal significance and may result in the overly broad legal opinion, of little practical benefit to the recipient, which creates potential legal problems for the lawyer rendering the opinion. If there is a law or set of laws that is of particular concern to the recipient party and compliance is subject to legal verification by the opining lawyer, this issue can be dealt with specifically in the opinion.

2. Factual Opinions

A closely related area of differences between counsel is the request for an opinion covering what are essentially factual matters. Lawyers should be cautious in agreeing to render opinions as to purely factual issues, such as opinions regarding financial reports and statistical data or opinions requiring the lawyer to state that, to his or her knowledge, the client is not in material breach of any representation or warranty made in the agreement. Such opinions are often requested to force a lawyer to make a more thorough investigation than the client may be inclined to make and thereby place the lawyer in the uncomfortable position of becoming an additional warrantor of the facts as represented.

The lawyer should always bear in mind that the function of his or her legal opinion is to present informed judgments and analysis regarding matters of law, not factual statements which the parties are, no doubt, in a better position to verify. If the requesting lawyer insists upon a representation that relates only to the knowledge or awareness of the issuer of the opinion regarding factual matters, such a representation should not be included in the opinion letter as a part of the legal opinion but, rather, more properly included in a separate letter or a separate section of the opinion letter in a manner which distinguishes it from the legal opinion. If this material is clearly distinguished from the portion of the letter containing the legal opinion, readers of the opinion

12. See infra notes 38-40 and accompanying text.
13. Clearly the opinion letter should precisely state the assumptions upon which the legal conclusions are based. The assumed facts cannot be inconsistent with facts actually known by the lawyer and reasonably prudent conduct may dictate that the lawyer make an appropriate verification of important facts rather than blindly assuming their accuracy. Fuld, supra note 3, at 921; MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 7-102 (1981). It has been held to be negligence for a lawyer to fail to undertake research sufficient to make informed and intelligent judgments. Smith v. Lewis, 13 Cal. 3d at 358, 530 P.2d at 595, 118 Cal. Rptr. at 627.
will understand that such representations do not constitute legal advice. Such placement of factual material may also serve to bring focus to the effort and expense involved in rendering a purely factual representation. Similarly, when an attorney is asked to render opinions of mixed law and fact, the attorney should state clearly those facts upon which the conclusions of law are based, particularly when reasonable attorneys might differ as to the conclusions.

There are some matters of a factual nature which may, under the circumstances, be appropriate subjects for a legal opinion. For instance, the lawyer may be requested to give an opinion that, to his or her knowledge, there are no legal actions pending or threatened against the client other than as set forth on an exhibit to the agreement. Although the requested opinion is factual in nature, some lawyers believe that lawyers representing clients in business transactions may have a special awareness of pending or threatened matters, or a special ability to verify the existence or nonexistence of such matters from the client's records or from court records, and should be in a position to make such a factual statement. Once again the appropriateness of such an opinion depends upon the circumstances involved and, if there is some disagreement among counsel regarding the propriety of the requested opinion, the matter should be resolved early in the transaction.

3. Opinions Regarding Issues of Legal Uncertainty

A third area of disagreement involves requested opinions concerning legal issues that may be appropriate for inclusion in an opinion but are subject to a generally recognized and substantial legal uncertainty. If the uncertainty extends only to a portion of the matter covered by the opinion, the question is frequently resolved by a "qualification" to the opinion expressed. The "qualification" may be a statement that the

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14. As noted in the text, the expression of a legal opinion may involve representations regarding underlying facts. The law is unclear regarding an attorney's responsibility to substantiate and verify the facts on which legal opinions are based and the extent to which an attorney may reasonably rely on information provided by the client. Clearly, an attorney faces liability for factual errors that are willful, fraudulent, and deceitful. Liability for negligent misrepresentation may exist when an attorney makes a false statement under circumstances where he or she honestly believed it to be true, but had no reasonable ground for such belief. Roberts v. Ball, Hunt, Hart, Brown & Baerwitz, 57 Cal. App. 3d 104, 111, 128 Cal. Rptr. 901, 906 (1976).

15. There are certain specialized areas in which attorneys normally render factual or "quasi" factual opinions. In securities underwritings and corporate reorganizations involving publicly-held companies, the lawyer will participate in the preparation of the registration statement or proxy statement filed with the Securities and Exchange Commission. Lawyers normally render an opinion based upon this participation to the following effect: "We are not aware of any factual information which would lead us to form a legal opinion that the [document] contains an untrue statement of a material fact." The attorney typically qualifies this opinion with respect to the lack of independent verification of the facts. The term "quasi" is from Bermant, The Role of the Opinion of Counsel: A Tentative Re-evaluation, 49 Cal. St. B.J. 132, 190 (1974) (well-reasoned views of the appropriateness of coverage of various matters in legal opinions in business transactions).
particular opinion does not cover the effect of a certain law or laws. Such qualifications are common under California law when the opinion relates to any agreement containing continuing covenants by one party and providing for specific remedies in the event of any breach of those covenants. If the attorney is asked to provide an opinion as to the enforceability of an agreement, there are substantial questions with respect to the availability of certain remedies, such as specific performance, or any remedy in the event of nonmaterial breaches. The lawyer may be satisfied that the principal obligation is enforceable in some manner under most circumstances and will therefore render an opinion, but set forth appropriate exceptions to his or her legal conclusions. Such a qualification should be acceptable to the lawyer for the other party if it concerns a generally acknowledged legal uncertainty.

The situation is different when the uncertainty goes to the principal subject of the opinion. In such cases the lawyer requesting the opinion is often seeking legal "insurance" rather than legal "assurance." As noted above, a lawyer should not ask for a legal opinion that he or she knows he or she would not be prepared to render under the circumstances. Similarly, a lawyer should not render an opinion when there is a substantial legal uncertainty regarding an issue. If there is disagreement regarding the existence or degree of the legal uncertainty, a compromise is sometimes reached, and a "reasoned" opinion is rendered. In such an opinion, the lawyer does not merely render a legal conclusion; instead, the lawyer presents a discussion of statutory and judicial authorities, indicates that the matter is uncertain or "not free from doubt," and states a prediction of the likely judicial resolution of the matter if the issue is appropriately presented to a court.

Although such an opinion arguably provides some comfort to the recipient and hopefully provides some limitation on the responsibility of the lawyer rendering the opinion, such narrative discussions in legal opinions are not favored, except, perhaps, in those instances in which the laws of several jurisdictions are involved and the requested opinion relates to issues of law that are unique or unusual in one of the affected jurisdictions (for example, the California usury law). In such instances

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16. There is uncertainty among attorneys and commentators with respect to the necessity of including certain "standard" qualifications. See infra pp. 1024-26.
17. The term "reasoned" is also from Bermant, supra note 15, at 134.
18. An attorney will not be held liable for errors in the application or interpretation of legal principles that are debatable or uncertain and "will not be held responsible for failing to anticipate the manner in which the uncertainty will be resolved." Metzger v. Silverman, 62 Cal. App. 3d Supp. 30, 39, 133 Cal. Rptr. 355, 361 (1975). Nevertheless, if the attorney's investigation and research leads to the conclusion that the law is unclear, the attorney should so inform the client and clearly note the uncertainty in the opinion. Fuld, Lawyers' Standards and Responsibilities in Rendering Opinions, 33 Bus. Law. 1295, 1306 (1978).
the text of such discussions should be fully resolved to the satisfaction of the lawyers and their clients prior to completion of the transaction. The Committee believes that often such matters are resolved more appropriately when the recipient of the opinion obtains the views and advice of the recipient's own lawyer, rather than including a narrative discussion in an opinion delivered at the closing of a business transaction.19

4. Comfort Opinions

A form of opinion closely related to the "reasoned" opinion and the "factual" opinion is the "comfort" opinion or letter, that is, a writing in which a lawyer represents that, based upon his or her participation in the matter, the lawyer knows of no misstatements or omissions in the client's representations. If the lawyer agrees to furnish such an opinion, he or she should seriously consider placing express limitations on the scope of the opinion by the use of introductory language qualifying the opinion as to the extent of his or her investigation, participation and/or independent verification of facts. The lawyer should also consider including a cautionary note as to the advisability of reliance on the opinion. Such qualifications should appear in the text of the opinion as well as in any accompanying documents likely to be viewed by other parties to the transaction.20

C. The Time to Negotiate the Opinion

Legal opinions in business transactions are normally rendered pursuant to the terms of an underlying agreement between the parties to the transaction, such as a loan agreement, a corporate acquisition agreement or an underwriting agreement in a securities transaction. The agreement typically sets forth in specific terms the text of certain legal conclusions that are to be included in the opinion as a condition to the "closing" of the transaction. On other occasions, the agreement merely describes generally the matters that are to be covered by the opinion.21 In either event, the exact text of the opinion to be rendered should be

19. By obtaining and relying upon the advice of counsel, the party seeking the opinion may also be able to retain less than favorable advice within the protection of the attorney-client privilege.
21. Counsel for the recipient of the opinion will sometimes include a provision in the agreement that the opinion will cover "such other matters" as counsel for the recipient "may reasonably request." This provision can create substantial uncertainty and place the attorney rendering the opinion in a difficult position with his or her client if the attorney is reluctant to opine on a new matter raised a short time prior to a closing. See Fuld, supra note 3, at 936-37. Such a provision can also be abused by the party whose closing obligations are conditioned upon the delivery of the opinion if the party demands an unreasonable opinion and thereby seeks to avoid the closing altogether.
agreed upon as early as possible in the transaction, preferably before the time the agreement is signed.

Although the opinion is normally not delivered until after the agreement is executed, serious differences often arise between counsel for the respective parties concerning the form and substance of the various legal matters to be covered by the opinion. If resolution of these matters is postponed until a short time before the closing, the result will often be either a form of opinion based unfairly on the superior bargaining power of one party or possible misunderstandings between the attorney reluctant to render a certain opinion and his or her own client. Resolution of these differences early in the transaction will allow the attorney to focus on the matters that require factual and legal verification and thereby allow the transaction to proceed to a timely closing.

Furthermore, although the scope and nature of the lawyer's obligation to verify the facts and rules of law upon which the opinion is based will depend, in part, upon the circumstances involved in the business transaction, a last minute, hasty preparation of the opinion raises the possibility that the opining lawyer will fail to discharge adequately his or her responsibilities as an adviser to the client.

**D. The Form and Elements of the Opinion**

There is no prescribed form for a legal opinion. Opinions, however, have developed a certain uniformity because of their continued use in similar business transactions, such as business acquisitions, secured and unsecured loan transactions, and securities issuances. The legal opinion in general will cover (1) certain introductory matter, such as the date, the identity of the recipient of the opinion, the role of the lawyer giving the opinion and the purpose for which the opinion is given, (2) a general or specific recitation of the factual and legal matters reviewed by the lawyer, including in some instances a statement of certain factual assumptions,\(^2\) and the reliance of the lawyer upon such matters of fact and law, (3) the legal conclusions covered by the opinion, and any qualifications to these legal conclusions not covered by the opinion, (4) special matters peculiar to the particular opinion, such as matters relative to opinions of local counsel in other jurisdictions, specific limitations on the use of the opinion, and the lawyer's qualification with

\(^{22}\) In rendering opinions, lawyers often assume the genuineness of signatures, correctness of facts set forth in certificates, and the proper corporate power and authorization by other parties to a contract. *See* Fuld, *supra* note 3, at 921. When a lawyer accepts documentation from his or her client and assumes the correctness of such documentation in forming the opinion, the lawyer may be representing to the other parties in the transaction that he or she is acting reasonably and without knowledge or suspicion of other facts which would indicate what further investigation should be made. Bermant, *supra* note 15, at 138 n.6.
respect to his willingness to pass upon matters of law in jurisdictions other than those in which the lawyer is licensed, and (5) the form of signature.

1. Introductory Matters

Date. The legal opinion will normally be delivered at the completion of the business transaction and bear that date. The opinion will be considered to speak as of this date, and there is no need to specify the effective date of the opinion separately. If for some reason a conclusion expressed in the opinion is as of a date prior to the delivery of the opinion, this fact should be clearly specified. An example of this latter situation is when a lawyer expresses an opinion that equipment or similar personal property is not subject to any perfected security interest under the California Uniform Commercial Code. Since the records of the California Secretary of State cannot be verified on a current basis, any opinion with respect to these and similar liens would have to be based upon filings as to the most recently verifiable date.

It is not improper for the lawyer to deliver an opinion to a party or intermediary in a transaction that bears a later date with instructions to the recipient that the opinion is to be delivered on its effective date (generally the closing date of the transaction). The opinion, however, should be deliverable only upon the telegraphic or telephonic authorization of the opining lawyer given at the time of delivery. Furthermore, whether the opinion is delivered personally by the rendering lawyer or through a third party, the lawyer should bear in mind his or her responsibility to confirm that the factual and legal matters covered in the opinion are accurate and correct as of the date the opinion is given. This obligation would include such matters as confirming, as of the closing date, the continuing good standing of the corporation and updating any factual certificates and similar matters.²³

Addressee. The opinion is normally addressed to a specified party to the business transaction in an individual capacity, to a party as representative of a larger group, or to an identified class of persons. Examples of the latter two situations are "XYZ Underwriting Firm, as representative of the several underwriters" and "to the purchasers of the 5% promissory notes of ABC Corp." In all cases the recipient of the opinion should be specifically identified. A lawyer may also be called upon to render a separate opinion to his or her own client as part of the

²³ With respect to the due diligence standards applicable to such certification efforts, see supra notes 3, 5, 13 and 14 and accompanying text.
closing conditions to a particular business transaction, in which case the opinion is addressed to the client.

The Committee's view is that the only person or persons entitled to rely upon an opinion are the person or persons to whom the opinion is specifically addressed and that no additional limitation need be expressed in the opinion. Many firms, however, as a matter of caution include a sentence at the conclusion of the opinion to the following effect:

This opinion is rendered solely for your information and assistance in connection with the above transaction, and may not be relied upon by any other person or for any other purpose without our prior written consent.

There are instances in which the opinion is to be relied upon by other persons or legal counsel, such as an opinion delivered to an underwriter concerning the validity of a proposed stock issuance which is also to be relied upon by the issuer's transfer agent and registrar, or an opinion rendered by a local counsel in a transaction when the lawyers principally involved will rely on the opinion to render their own opinion. In such cases, the opinion should specifically describe who, in addition to the addressee, may rely on the opinion.

The foregoing discussion does not deal with situations in which the opinion is being rendered to a client, and the lawyer knows or has reason to believe that the client will be utilizing the opinion in dealing with third parties. In such cases, the lawyer's responsibility probably extends to these additional persons, and limitations expressed in the opinion will likely have little legal effect. For this reason the potential liability of the opining lawyer is greater and therefore the issuance of such an opinion should be considered carefully, particularly with respect to the need for greater qualification of the advice given.

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

The Transaction and the Lawyer's Role. The opinion should set forth the capacity in which the lawyer is rendering the opinion and a description of the transaction. This typically can be accomplished in a single sentence such as:

We have acted as counsel to ABC Corp., a California corporation ("ABC"), in connection with the merger of ABC with and into XYZ Corp., a California corporation ("XYZ"), pursuant to the Agreement

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and Plan of Reorganization dated as of __________, 19—, by and between ABC and XYZ (the "Agreement").

The attorney may wish to designate further his or her role as "general" or "special" counsel. The Committee is of the view that such additional descriptive language should not normally be used, unless the opinion is being rendered by an individual who is inside general counsel for the corporation. For other counsel, the use of "general" may indicate some continuing knowledge of all corporate affairs that are beyond the scope of the opinion, while the use of the word "special" would not appear to limit the lawyer's responsibility for the opinions rendered in a transaction in which he or she has represented the client generally. If the lawyer is not involved generally in representing the client in the particular transaction, and has been requested to give an opinion on a limited matter, it may be advisable to describe specifically the scope of his or her limited involvement, rather than by implying a limited participation by the reference to "special" counsel. Furthermore, the term "special" counsel would normally be used as a reference to a lawyer who has been asked to render an opinion as a specialist in the field of law discussed in the opinion.25

The lawyer will also often state that he or she has participated in the preparation of the agreement in question and, usually by inference, in the exhibits that are part of the agreement. Although such statements may provide additional "comfort" to the recipient of the opinion that legal counsel has been involved throughout the transaction, the practice may be inadvisable insofar as the opining lawyer is concerned. By offering such comfort, the lawyer may raise some implication that he or she is assuming some responsibility for factual matters set forth in the agreement, including the exhibits. The assumption of this responsibility is normally well beyond the lawyer's role.26

Reasons for the Opinion. The lawyer should specify why the opinion is being rendered. This requirement typically is accomplished by a simple reference: "This opinion is rendered pursuant to Section — of the Agreement."

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

25. See infra pp. 1028-29.
26. See supra pp. 1009-12, for a discussion of factual and "comfort" opinions.
The terms used in this opinion which are defined in the Agreement shall have the same definitions when used herein, unless otherwise defined herein or unless otherwise clearly required by the context.

Whenever a term utilized in the opinion is derived from statutory law, the lawyer should take care to use that term as it is used in the applicable statute. For instance, the California General Corporation Law refers to “Articles of Incorporation,” “shareholders” and “shares,” rather than “Certificate of Incorporation,” “stockholders” and “stock” as used in statutes of certain other jurisdictions.

3. Factual Examination

Description of Factual Examination. The lawyer must be satisfied that he or she has reviewed sufficient facts to support each of the legal conclusions expressed in the opinion. In most instances, the opinions normally expressed can be supported by an examination of documents, either in their original form or copies identified to the satisfaction of counsel, or of certificates of public officials or officers of the client corporation relating to factual matters.

Some lawyers preface their opinions by reference to a detailed list of the documents and certificates examined, together with either a statement that they have examined such other documents and made such further legal and factual investigation as they deem necessary for purposes of rendering the opinion or, alternatively, a specific disclaimer that they have made any other examination or factual investigation.

Other opinions merely set forth language to the following effect:

We have been furnished with and have examined originals or copies, certified or otherwise identified to our satisfaction, of all such records of the Company, agreements and other instruments, certificates of officers and representatives of the Company, certificates of

27. A common form of statement to this effect is as follows: “We have made such further legal and factual examination and investigation as we deem necessary for purposes of rendering the following opinions.”

28. Such limitations on the scope of a lawyer’s examination of factual matters is normally expressed only in special circumstances as when the lawyer has an extremely limited role in the transaction. Such circumstances should be clearly set forth and a sentence to the following effect should be used to express the limited investigation:

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

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

In giving the opinion expressed in paragraph ____ above, we have relied with your approval solely upon the certificate of listing all evidences of indebtedness, agreements and instruments to which the Company is a party and all judgments, orders and decrees of any court or arbitrator binding upon the Company.

See also infra pp. 1020-23, for a discussion of officers’ certificates.
public officials and other documents as we have deemed it necessary to require as a basis for the opinions hereinafter expressed. As to questions of fact material to such opinions, we have, where relevant facts were not independently established, relied upon certifications by principal officers of the Company.

At times the decision whether to set forth a list of documents and certificates reviewed by the lawyer is dictated by the recipient of the opinion. Certain lending institutions and securities underwriters desire the "long-form" opinion to provide the additional comfort that the lawyers have made some appropriate review for purposes of their opinion. In most instances, however, the decision is based on the preference of the attorneys rendering the opinion, and it is sometimes influenced by whether the attorneys have represented the client in general matters for some time or only for purposes of the specific transaction. If the attorney intends to limit the scope of the opinion to the documents and certificates listed, this limitation should be stated explicitly in the opinion. If no specific limitation is given, the inclusion of a detailed document list should not be understood to constitute a limitation on the attorney's general responsibility in rendering the opinion. Even if the recipient accepts the list as the sole basis for the opinion, the attorney would nevertheless likely remain responsible if he or she had knowledge of facts contrary to those set forth in the documents or certificates listed or had reason to believe that such facts existed.

Reliance on Certificates of Public Officials. Opinions in business transactions almost always include some legal conclusion concerning the incorporation and existence of the client corporation and its ability to transact business in its state of incorporation. Opinions also often include legal conclusions concerning the good standing and ability of a corporation to transact business in other jurisdictions. The principal sources of verification of these matters are certificates issued by public officials in the various jurisdictions involved. For California corporations, the California Secretary of State and the Franchise Tax Board are the principal sources of such information. The principal certificates are as follows:

1. Certified Copy of the Articles of Incorporation Together with Amendments. A copy of the articles of incorporation, and all amendments thereto, certified by the California Secretary of State. This certification represents conclusive evidence of the formation of the corporation and prima facie evidence of its existence for all purposes other than in an action by the California Attorney General. 29 If

these documents are ordered by mail, delivery may take two or three weeks. They can normally be obtained in four or five days through various independent document services.

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

3. Of Status Certificate. A Certificate of Status of a Domestic Corporation furnished by the Secretary of State (commonly referred to as a "Good Standing Certificate"), which certifies the corporation's organization, good legal standing, authorization to exercise corporate powers and ability to transact business in California. This certificate also will verify that no documents relating to the winding up and dissolution of the corporation have been filed with the Secretary of State. This certificate can normally be obtained within a few days prior to the rendering of the opinion or over the counter in Sacramento.30

4. FTB Tax Clearance Letter. A letter from the California Franchise Tax Board stating that the corporation is in good standing and has no known unpaid tax liability. This letter can also normally be obtained by telephonic or written order a few days prior to the closing and provides verification that no proceedings are pending to suspend the corporate powers of the corporation.

The attorney may also verify by telephone with the office of the Secretary of State that the status of the corporation has not changed as of the date the opinion is being delivered. The Franchise Tax Board will also confirm good standing by telephone. Neither the Secretary of State nor the Franchise Tax Board will any longer issue such confirmation by telegram.

Public officials in other states will furnish similar certificates relating to good standing and tax delinquencies, and these can normally be updated by telegram to the date preceding the delivery of the opinion. When certificates and telephonic confirmation are required from public officials in foreign jurisdictions, the attorneys rendering the opinion should inquire, well in advance of closing, about the procedures for

30. A corporation's repeated failure to file the Annual Statement required under section 1502 of the California Corporations Code may lead to suspension by the Secretary of State of its ability to transact business. CAL. CORP. CODE §2204. The fact and date of filing can be confirmed with the Secretary of State by telephone to assure that the corporation has not been suspended as of that date.
obtaining the certificates and confirmations and the amount of time that should be allowed for timely receipt. Since procedures in any jurisdiction can, and often do, change with some frequency, a rule of reasonableness should also apply to this aspect of the lawyer's investigation.

Certificates of public officials are also available as support for other areas of a legal opinion. If an opinion is being rendered with respect to liens or encumbrances on personal property, the Secretary of State will provide a certificate listing all financing statements filed under the California Uniform Commercial Code and a variety of other liens that are perfected by filing with the Secretary of State. This certificate, however, is obtainable only as of a date sometime prior to the closing and cannot be updated by telegram. This limitation on availability is due to the volume of filings and recordings in the Secretary of State’s office. Similar certifications with respect to filings under the Uniform Commercial Code can be obtained from other jurisdictions. Licensing bodies, such as the Departments of Insurance, Corporations or Banking, will also normally provide certificates relating to the existence of particular licenses.

Since these various certificates of public officials will normally bear a date prior to the delivery of the opinion, the opining attorney must decide what additional verification, if any, is necessary for purposes of the opinion. Although in many instances telegrams can be obtained updating certain of the information to the closing, this is not always the case. The responsibility is that of the opining lawyer and additional verification may or may not be necessary depending upon his or her familiarity with the client and the facts and circumstances of the case. It is the view of the Committee that reasonable prudence does not require that every certificate be updated for purposes of rendering an opinion.

**Officers’ Certificates.** There are two somewhat analogous types of officers’ certificates in general use in rendering opinions in business transactions: (a) certificates verifying the authenticity of referenced documents; and (b) certificates relating to factual matters not readily verifiable by the opining attorney. A common example of the first type of certificate is the certificate of the secretary of the client corporation that, attached to the certificate, is a true copy of the bylaws and corporate minutes or resolutions pertaining to the transaction. A typical form of such certificate begins with the caption “Certificate of Secretary of XYZ Corporation” and continues as follows:

I, John Doe, certify that I am duly elected and acting Secretary of
XYZ Corporation, a California corporation (the "Company"), and that attached hereto as Exhibit A is a true and correct copy of [the bylaws of the company] [resolutions of the Board of Directors of the Company duly adopted at a special meeting of the Board held on_______, 19_____] and that the same have not been [amended] [rescinded or changed] and are now in full force and effect.

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

The signatures and corporate capacities of the individuals executing an officers' certificate may also be supported by an incumbency certificate containing the signatures of various corporate officers who have signed documents pertinent to the transaction. Following an appropriate caption this certificate generally takes the following form:

I, John Doe, certify that I am the duly elected and acting Secretary of XYZ Corporation, a California corporation (the "Company"), and that at all times from _______, 19____ to and including [the closing date] the following were the duly elected and acting officers of the Company and their true signatures appear opposite their names:

<table>
<thead>
<tr>
<th>Title of Officer</th>
<th>Name of Officer</th>
<th>Signature</th>
</tr>
</thead>
<tbody>
<tr>
<td>John Doe, Secretary</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The certificate then customarily closes with an officer other than the secretary attesting to his or her signature.

The officers' certificates are often delivered to the other party to the transaction at the closing to provide assurance, in addition to the opinion of counsel, that corporate action has been properly taken. These certificates will normally be obtained even though the lawyer may have reviewed the bylaws of the corporation, all minutes contained in the minute book and the stock records.

The second type of officers' certificate relates to factual matters not readily verifiable by the lawyer when preparing the opinion. Such certificates are used as factual support for legal conclusions expressed in
the opinion. An example of such factual matters arises when a lawyer renders an opinion that the transaction will not create a breach under the terms of any loan agreement to which the client is a party. The lawyer is competent to review most of the pertinent provisions of such loan agreements for purposes of rendering this opinion. The lawyer, however, may need an officers’ certificate to identify the various loan agreements to which the corporation is a party (the lawyer will often rely on an exhibit to the underlying agreement for this purpose, if such documents are listed). The lawyer may also require an additional certification that provisions in such loan agreements relating to minimum financial ratios will still be satisfied after the completion of the transaction in question. Another example arises when the opinion includes a conclusion that the corporation is qualified in all foreign jurisdictions in which such qualification is necessary or that any lack of qualification would not result in a material liability to the corporation. In such a case, the lawyer usually obtains certification with respect to both the location of properties owned or leased in states other than the state of incorporation and the corporate offices or employees outside the state of its incorporation. In obtaining such certificates, which are normally prepared as to form by the lawyer, the lawyer should take care that the certificate does not only restate legal conclusions (for example, the corporation is duly qualified as a foreign corporation in all jurisdictions in which such qualification is necessary), but also recites factual matters reasonably within the competence of the officer signing the certificate. If legal conclusions are merely set forth in the certificate, the certificate may be of little assistance in the event that the legal opinion is subsequently questioned.

Practice differs with respect to the delivery of these factual “back-up” certificates at the closing or to legal counsel to the other party to the transaction, although the opinion should always refer generally to “officers’ certificates” if the lawyer is relying on one or more of such certificates. Some lawyers prefer to attach the certificates to their opinion in the belief that, if the other party does not object to the matters set forth in the certificates, there is at least some implicit understanding that the attorney could appropriately rely on the statements contained therein in rendering the opinion. Other attorneys prefer to deliver the form of certificate to counsel for the other party prior to the closing for the same purpose. Unless the lawyer rendering the opinion has expressly limited the scope of investigation to documents described in the opinion, it is the Committee’s experience that the lawyer expressing

31. See infra pp. 1033-34.
32. See supra note 28 and accompanying text.
the opinion does not generally deliver supporting officers’ certificates to the other party or its counsel. Furthermore, the recipient of the opinion does not generally request an opportunity to review such certificates. Therefore, the opining lawyer must use his or her own best judgment in determining under what circumstances (and to what extent) reliance on factual matters contained in the certificate can be justified. The opining lawyer should also exercise his or her own judgment in determining those circumstances and matters which reasonably should be supported by an officers’ certificate. When officers’ certificates are utilized to define and limit the extent of investigation underlying the opinion, the lawyer representing the recipient of the opinion should normally review supporting documentation referenced by the opining lawyer, particularly when the opining lawyer disclaims reliance on any investigation other than that specified in the opinion.

**Documentary Examination Assumptions.** There are certain assumptions commonly made by the lawyer in his or her documentary examination. These typically include assumptions that the signatures on all documents examined (other than those documents executed by one’s client in connection with the underlying transaction) are genuine, that copies of documents examined conform to the originals and that such documents were duly authorized and properly executed. The lawyer will sometimes specifically set forth these assumptions in the body of the opinion, but more frequently they are omitted and the Committee is in accord with this practice. By expressly stating certain assumptions in the opinion, there may be some implication that no other assumptions exist. That implication in turn encourages an attempt to set forth a “laundry list” of all conceivable assumptions.\(^3\)

4. **Expression of the Opinion**

**Introduction.** The substantive portion of the opinion normally begins with an introductory statement, leading into the opinion, referring to matters upon which the lawyer has relied. This introductory material is generally phrased in a manner which does not limit the lawyer’s investigation to the matters specifically described, but rather that the lawyer has made such further investigation as he or she deems appropriate under the circumstances. An example is as follows:

Based on the foregoing and upon such further investigation as we have deemed necessary, it is our opinion that:

The expression of the opinion (that is “it is our opinion that”) varies

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\(^3\) See infra note 37 and accompanying text.
according to the practice of the particular attorney. Lawyers also use such acceptable terms as “we are of the opinion that”; “we express the following opinions”; or “our opinion is as follows”. Sometimes lawyers will use “we advise you that”; or “we believe that”; or “we are of the view that”. These latter variants may imply that something more or less than a normal opinion is being rendered and normally are not used in business transactions.  

The Operative Language. The types of opinions expressed in business transactions have become somewhat customary and uniform. Part V of this Report provides examples of several typical opinion forms used in such transactions and includes a discussion of the meaning of the terms commonly used in such opinions and the uncertainties and particular problems existing under California law. Suggested procedures to be followed in rendering opinions are also included. Nevertheless, some general observations regarding operative language will be offered here.

Qualifications. Qualifications to an opinion are presented in different forms, depending upon the preference of the attorney and the length of the qualification. If the qualification is short and applies only to one portion of the opinion, it will normally be included in the operative language of the opinion by the reference “subject to . . .” or “except . . .”. If the qualification pertains to more than one portion of the opinion or is lengthy, it will generally be placed after the operative opinion clauses. Typical introductory clauses are “our opinion in paragraph — is subject to”; or “we express no opinion on the effect of”; or “in rendering our opinion in paragraph —, we have assumed, with your consent, that [describe assumptions]”.

Qualifications can cover a variety of matters. The qualification may relate to assumptions of facts that are particularly within the knowledge of the recipient of the opinion or to present or future facts that both parties agree may be reasonably assumed. An example of the former would be a securities opinion related to the receipt of shares free and clear of all liens. Under the California Uniform Commercial Code, a purchaser who acquires securities for value in good faith without notice of adverse claims acquires the securities free of any adverse

34. See Fuld, supra note 3, at 922. The author points out that “advise” may suggest a definiteness that implies higher standards than the normal opinion, while “believe” and “view” may imply a more casual judgment than contained in a normal deliberative opinion. While the Committee is not in total agreement with this position, the possibility of a different interpretation being ascribed to the opinion should be considered if a lawyer departs from the conventional opinion language.
claim. If such an opinion is being given, the attorney will generally include an assumption that “the purchaser is acquiring the shares in good faith without notice of any adverse claim.” Since these facts are within the knowledge of the purchaser, such a qualification is appropriate.\textsuperscript{35}

The typical securities transaction can also provide an illustration of an appropriate qualification with respect to a future fact. The attorney will sometimes begin an opinion regarding title and the absence of liens and encumbrances with the qualification that the described status will exist: “upon delivery by the seller of the certificates for the shares and payment therefor.” Such a qualification is based upon logical assumptions which are normally acceptable to counsel for the other party.

A second type of qualification relates to matters that are subject to some legal uncertainty. An example of this qualification is the uncertainty in the terms “valid, binding and enforceable” discussed in Part V of this Report. Another example would be the effect of a choice of law provision in an agreement between parties domiciled in different jurisdictions or a general assumption that California law applies. This type of qualification is normally not used if it relates to the principal purpose of the opinion clause.\textsuperscript{36}

A related type of qualification is given when the lawyer rendering the opinion does not have responsibility for compliance with certain laws. For instance, a lawyer rendering an opinion regarding the valid issuance of shares of stock may have expressly limited the scope of the opinion to exclude questions regarding compliance with the securities laws of various jurisdictions in which the purchasers of the shares reside. Although this qualification normally does not affect the validity of the issuance of the shares, the lawyer will often introduce the opinion with a prefatory phrase “subject to compliance with applicable state securities laws . . . .”

The question of what qualifications should necessarily be set forth in the opinion is itself subject to considerable difference of opinion. Some lawyers set forth few qualifications in the belief that reasonable assumptions and limitations should be and are implicitly contained in any opinion, whether or not set forth. Other lawyers include all conceivable qualifications as a matter of practice. The latter view presently appears more prevalent and has led to a proliferation of lengthy opin-

\textsuperscript{35} The purchaser and his or her counsel may seek to bolster their position regarding good faith and lack of notice by requesting a representation from the seller and his or her counsel that they are not aware of any adverse claims with respect to the subject securities or property which are not contemplated to be settled or adequately provided for on or before the closing date.

\textsuperscript{36} An alternative sometimes used is the “reasoned” opinion. See supra note 17 and accompanying text.
ions, particularly in California. The Committee does not believe this practice is necessary.

**Limitations on the Basis of Knowledge.** Various portions of the opinion are often limited by reference to the lawyer's "knowledge." These limitations take many different forms. The limitation is commonly phrased "to our knowledge"; "to our actual knowledge"; "to the best of our knowledge"; "we do not know of"; "we are not aware of"; or "nothing came to our attention". Most, if not all, of the foregoing qualifications imply some lack of factual investigation by the opining lawyer, and the problems of appropriate limitations on the basis of knowledge may very well be different for law firms as contrasted with individual practitioners. Commentators, however, are not in agreement with respect to the implications of these various forms.

The Committee believes it preferable to describe the kind of investigation that has been made. This approach does not leave the question to be decided at some future time. If no investigation or a very limited investigation has been made, the fact should be expressly noted as a qualification to the opinion.

5. **Special Matters**

**Foreign Law and Reliance on Local Counsel.** The principal lawyer in a business transaction normally renders an opinion covering the laws of his or her state of admission and the applicable federal laws and sets forth this limitation in the text of the opinion. The lawyer often is also requested to furnish an opinion on matters governed by the laws of some other state or country. Since the lawyer may be held to the same

37. See Jacobs, Opinion Letters in Securities Matters: Text-Clauses—Law (1980) (suggesting a prolific use of qualifications). Compare id. with Babb, Barnes, Gordon & Kjellenberg, Legal Opinions to Third Parties in Corporate Transactions, 32 Bus. Law. 553, 564 (1977) ("enforceable" does not mean that an agreement will be enforced under all circumstances or that any particular remedy is available).


39. Compare Fuld, supra note 3, at 992 ("to the best of our knowledge" may indicate a considerable investigation) with Jacobs, supra note 37, at Intro—14 ("to the best of our actual knowledge" does not imply any investigation).

40. Several members of the Committee felt that, due to the prime importance of the issue of knowledge in the context of malpractice litigation, every representation as to knowledge, awareness and the like should be expressly qualified by some agreed-upon description of the burden of inquiry, if any, expected to be conducted by the lawyer making the knowledge qualification. Such qualifications will assist the opining lawyer in responding to allegations that relevant facts existed at the time the opinion was rendered that would have been discovered in a more thorough investigation.

41. A common form of limitation is:

We are opining herein as to the effect on the subject transactions only of the laws of the State of California and of federal law, and we assume no responsibility as to the applicability thereto, or the effect thereon, of the laws of any other jurisdiction.
standard as a lawyer licensed in such other jurisdiction, he or she will, in most instances, seek the advice and opinion of local counsel. Professional responsibilities and potential liabilities in this regard are discussed in Part III of this Report.

There are certain uncomplicated questions of foreign law on which California lawyers will customarily render opinions. Since many lawyers generally experienced in corporate matters are familiar with Delaware corporation law, their opinions will cover matters relating to the incorporation and good standing of a Delaware corporate client and certain other routine corporate matters. California lawyers will also normally render an opinion that a California corporation is qualified to do business and is in good standing under the laws of other states, as these matters are normally verifiable from certificates of public officials. The Committee is of the view that California lawyers properly may opine on such uncomplicated matters involving the corporate laws and the fact of qualification in other jurisdictions, although the lawyer should always be cognizant of the fact that the rendering of an opinion regarding the legal principles applicable in foreign jurisdictions may increase his or her liability exposure.

The question becomes more difficult when the lawyer is asked to opine that the corporation is not required to qualify in any other jurisdiction or that a failure to qualify would not have a material adverse effect on its financial condition. Lawyers often give these opinions, relying in large part on factual certificates of officers with respect to the conduct of business and the location of properties and employees in other jurisdictions. This type of opinion requires an examination both of the qualification requirements of particular jurisdictions and of the penalty provisions for a failure to qualify and a factual determination of what is "material." Care should be used in this area, and local counsel should be retained if any material question exists. Because of the uncertainties, the requesting lawyer will often agree to forego such an opinion where it is only ancillary to the business transaction.

The retention of local counsel to furnish an opinion raises a series of different questions with respect to the principal lawyer's responsibility

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42. Some commentators believe there are indications that the lawyer rendering an opinion on a foreign law may be liable as an "insurer" if the opinion is incorrect. See Fuld, supra, note 3, at 937; cf. Horne v. Peckham, 97 Cal. App. 3d 404, 414, 158 Cal. Rptr. 714, 720 (1979) (general practitioner rendering opinion on area of legal specialty must exercise the same "care and skill ordinarily used by specialists" under similar circumstances).

43. Since the Uniform Commercial Code has been adopted in almost every state and standard compilations are available, lawyers will also sometimes render "foreign law" opinions in this area on uncomplicated matters. There are, however, significant differences among states in the Code provisions, and many conflicting judicial decisions.

44. See supra note 7 and accompanying text.
for the opinions expressed in the local lawyer's opinion. Often the principal lawyer will be requested to render an opinion on the same matters, or to include in his or her opinion some reference that the recipient is justified in relying upon the local counsel's opinion or that the local counsel's opinion is satisfactory as to form. If the principal lawyer renders an opinion on the same matters as the local lawyer, the opinion should clearly specify the reliance on the local counsel's opinion:

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

The principal lawyer's responsibility in all of these situations is not clearly established. The lawyer may have some responsibility both for selection of competent local counsel and for the substantive matters included in the opinion. The Committee is of the view that the principal lawyer's responsibility extends no further than the use of reasonable care in the selection of local counsel and that the recipient of the opinion should not assume that the principal lawyer has independently investigated or otherwise verified the law of the foreign jurisdiction. If, however, the principal lawyer's opinion states that the lawyer "concurs" in the opinion of local counsel, or that the local counsel's opinion is satisfactory in "substance" or that "we believe you are justified in relying upon" the opinion of local counsel, the principal lawyer may be held to have assumed some responsibility to examine the statutory and case law of the foreign jurisdiction.

As an additional safeguard, the local counsel's opinion should be addressed to the recipient, rather than the principal lawyer, and should provide that the principal lawyer may rely on the opinion in rendering his or her own opinion.

The preferable approach from the standpoint of the opining lawyer is to isolate his or her opinion from the opinion of local counsel. In the preliminary negotiations concerning the opinion, local counsel should be selected, and the agreement should separately provide for the receipt of local counsel's opinion with respect to specified matters as a condition to the closing. The principal lawyer should exclude from the scope of his or her opinion matters covered in the opinion of local counsel, and no reference to the local counsel's opinion should be made in the principal lawyer's opinion. This procedure will normally be acceptable to the lawyer for the recipient, as both parties have an interest in assuring that a competent local lawyer is retained. If the recommended procedure is utilized, the Committee believes that the principal lawyer
would probably not be held to have assumed responsibility either for
the advice contained in the local opinion or for the selection of local
counsel.

Reliance on Opinion of "Special Counsel." Considerations similar to
those arising in the selection and use of local counsel apply in the re-
tention of special counsel. In the decision of Horne v. Peckham, the
California Court of Appeal held that a lawyer who has no expertise in
a specialized matter should not render an opinion in the specialized
area, and should refer the matter to a lawyer qualified in that field.
The Committee believes that the principal lawyer should not furnish an
opinion on the same matters as the specialist, even though the opinion
is rendered solely in reliance on the specialist's opinion. Unlike local
counsel who is often retained as a safeguard, the specialist, by contrast,
is retained because the principal lawyer does not have sufficient exper-
tise to render the opinion.

Relationship of the Lawyer with the Client and Others. The lawyer
rendering the opinion may have a relationship with a client corporation
beyond that of "attorney-client." For example, the lawyer or a member
of his or her law firm may be a director or officer of the corporation,
may have a close family relationship with an officer, director or prin-
cipal shareholder, or may own or control a material number of shares in
the corporation. These relationships should not bear on the ability of
the lawyer to render an opinion. The attorney-client relationship is not
one of independence, and the lawyer would be expected to adhere to
his or her professional responsibilities in spite of that relationship.
These are matters, however, that are normally brought to the attention
of the other party to the transaction and its counsel. The Committee is
of the view that it is preferable to confirm these and similar relations-
ships in the opinion by a simple reference to the fact that "we advise
you that X, a member of our firm, is a director of ABC Corp. and [in
the event material stock ownership exists] that members of the firm
own beneficially ____ shares of common stock of ABC Corp." This
declaration eliminates the possibility that a lack of awareness of the
relationship will be raised in any subsequent litigation. Some comment-
tors also recommend that similar relationships, including current and
prior legal representation of another party to the transaction, also be
disclosed. 46

45. 97 Cal. App. 3d 404, 158 Cal. Rptr. 714.
46. See Fuld, supra note 18, at 1304. The author points out that there are other relationships
that may be considered to influence the lawyer's opinion for which it is difficult to decide whether
there is such a lack of independence as to require disclosure, such as significant unpaid legal fees.
6. Signature

Most firms manually sign the opinion in the name of the firm. Other firms follow different practices, such as “XY&Z by A, a partner” or “A on behalf of XY&Z”. If the opinion is signed only in the firm name, the firm should maintain a record identifying the signatory. On occasion, the lawyer for the other party to the transaction will request a separate written confirmation identifying the person signing the opinion. In any event, a partner or other authorized person should sign the opinion, eliminating any question as to authority to bind the firm.

7. “Back-Up Memorandum” and Internal Review

Lawyers often formalize the factual and legal review they conducted for purposes of rendering the opinion in a single memorandum or series of memoranda. This practice provides the lawyer with a permanent record of the procedures followed in the event portions of the opinion are subsequently questioned. A simple and orderly procedure is to set forth separately each opinion clause, and document below the clause the various steps taken to support the conclusions expressed.

Some firms have adopted some policy for internal review of each legal opinion of the firm prior to delivery at the closing. These reviews take different forms. Some firms require that another lawyer or lawyers experienced in the legal matters covered by the opinion review the underlying agreement, the various factual certificates and the “back-up” memoranda to assure that each legal conclusion has been properly reached and documented. Some firms utilize a separate “legal opinion” committee which reviews each opinion as to form and substance. This approach helps assure consistency in the form of the firm’s opinions. Other firms use a variant of these procedures.

V. CERTAIN STANDARD PROVISIONS AND SPECIAL PROBLEMS UNDER CALIFORNIA LAW

The following discussion is not intended as an exhaustive list of all types of legal opinions or of all the elements of legal opinions. Rather, this Part of the Report addresses several terms and provisions commonly used in opinions given in connection with business transactions, with special emphasis on problems unique to California.47

due from the client or the fact the client accounts for a substantial percentage of the law firm’s overall business.

47. Some of the discussion in this Section is adapted from Legal Opinions to Third Parties: An Easier Path, Report by the Special Committee on Legal Opinions and Commercial Transactions, New York County Lawyers’ Association, 34 Bus. Law. 1891 (1979) [hereinafter cited as New York County Lawyers’ Report] and from Babb, Barnes, Gordon and Kjellenberg, supra note 37. The
A. Corporate Status

Opinions as to corporate status are common in lending, stock purchase and other corporate transactions. Maintenance of corporate "good standing" is necessary, among other reasons, to preserve a corporation's right to prosecute, defend or appeal an action in California courts. Purchasers of corporate stock and others seeking to do business with a corporation often seek assurance that the company has not lost its corporate status. An opinion as to corporate status is almost always required by lenders proposing to make loans to corporations.

The corporate status portion of the opinion commonly reads as follows:

The Company has been duly incorporated and organized and is validly existing in good standing under the laws of the State of California.

Each of the principal phrases of this opinion conveys certain generally recognized meanings and is discussed below.

1. Due Incorporation

The term "duly incorporated" means that, at the time the corporation was formed, the legal steps necessary to perfect its formation were completed (that is, its articles were signed and filed with the Secretary of State) and that the articles contained all information required to perfect its formation (and did not contain any provisions prohibited) under the applicable corporate law as then in effect.

Section 209 of the General Corporation Law provides that, for all purposes other than an action by the California Attorney General in the nature of quo warranto, a copy of the articles of incorporation duly certified by the Secretary of State is conclusive evidence of the formation of the corporation and prima facie evidence of its corporate existence. The fact that the Secretary of State concluded that the articles of incorporation conformed to law when they were filed, as evidenced by the Secretary of State's acceptance of the articles for filing, typically gives lawyers satisfactory assurance with respect to the corporation's due incorporation.


49. It is somewhat difficult to examine the provisions of the General Corporation Law applicable to corporations formed prior to 1977. The standard code services do not maintain appendices or supplements containing these provisions.

50. CAL. CORP. CODE §209.
2. Due Organization

An opinion that a corporation has been "duly incorporated" does not mean that it has been "duly organized." A corporation could be "duly incorporated," but not "duly organized," if no steps other than signing and filing the articles had been taken. A corporation has been duly organized when its initial bylaws have been adopted and its initial officers and directors (in the minimum number required by law and the corporate charter documents) have been elected.51 The phrase "duly organized" is also commonly understood to require the board of directors to authorize the initial issuance of the company's capital stock. A corporation that is "duly organized" must have been "duly incorporated." Accordingly, many opinions state only that "the Company has been duly organized and is validly existing. . . ."

3. Validly Existing

To be validly existing, a corporation cannot have dissolved or ceased to exist by reason of a merger or the operation of a limitation on the duration of its existence in its articles of incorporation. The word "validly" is used to distinguish a "de facto" from a "de jure" corporation.

An opinion that a corporation is "validly existing" implies that no proceedings for dissolution have been commenced. Persons holding shares representing fifty percent or more of the voting power of a California corporation may, however, initiate the commencement of voluntary proceedings for the winding up of a corporation merely by filing with the corporation a written consent of the shareholders thereto. No certificate of election to wind up and dissolve pursuant to Section 1901 of the General Corporation Law need be filed with the Secretary of State to commence dissolution proceedings.52 When the voluntary proceedings for winding up have commenced, the corporation is required to cease carrying on its business except to the extent necessary for the beneficial winding up thereof, and except as the board may determine necessary to preserve its goodwill or going-concern value pending a sale of its assets.53 The lawyer normally verifies the "valid existence" of a corporation by obtaining a Certificate of Status from the Secretary of State and reviewing the corporate minute book to verify that no dissolution documents have been publicly filed or are contained in the corporate records, and on occasion, the lawyer may also obtain a certif-

51. See CAL. CORP. CODE §210. The board of directors need not adopt a corporate seal for a California corporation, because failure to affix a corporate seal to a document does not affect the document's validity. Id. §207(a).
52. Id. §1903(a).
53. Id. §1903(c).
icate of the principal corporate officers or shareholders that no dissolution proceedings have commenced. In a closely-held corporation, the written consent of shareholders filed with the corporation may not find its way into the minute book.

4. **Good Standing**

While the phrase “duly organized” relates to legal issues involved in the original organization of the corporation, the phrase “in good standing” involves its status at the time the opinion is issued. A California corporation is not in “good standing” in California if its charter is suspended or forfeited. Suspension or forfeiture can result if the corporation has failed to pay any tax, penalty or interest owing to the Franchise Tax Board, to file a tax return with the Franchise Tax Board or to file annual statements with the Secretary of State.\(^5\) Anyone exercising or purporting to exercise any powers of a corporation that is not in good standing is subject to criminal liability, and any contract entered into during this period is voidable at the instance of the other party to the contract. These circumstances continue until the corporation is revived by the payment of the delinquent tax, penalty or interest, or the filing of the required return or annual statement, and upon written application either to the Franchise Tax Board or to the Secretary of State, as the case may be.\(^6\)

Opinions on good standing can be based solely on a Certificate of Status from the Secretary of State.\(^6\) Confirmation of good standing of a corporation for franchise tax purposes can also be obtained from the Franchise Tax Board.\(^7\)

5. **Good Standing in Other Jurisdictions**

Lawyers are often asked to furnish an opinion with respect to corporate qualification in jurisdictions other than the state of incorporation. The determination of where a corporation *is qualified* to transact business is a fairly simple matter. On the other hand, an opinion of where a corporation *must be qualified*, particularly with respect to a company of any size and complexity, is difficult to render.\(^8\) Whenever possible, the lawyer should attempt to limit the opinion to named jurisdictions or

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54. See, e.g., CAL. CORP. CODE §§1801, 2204; CAL. REV. & TAX CODE §23301.
56. See *supra* pp. 1019-21.
57. See *supra* p. 1019. The Franchise Tax Board certificate may contain information not provided by the Secretary of State’s certificate. For example, the Franchise Tax Board certificate may alert counsel to the fact that the corporation is delinquent in the filing of a tax return or payment of a tax (though not so delinquent as to have its corporate powers suspended or forfeited). See Chang, *supra* note 48, at 9.
58. See *supra* p. 1027-28.
those which can be determined by objective facts, such as those jurisdictions in which the company owns or leases real property, maintains offices or inventories or has employees. In the latter case, it will be necessary for the lawyer to obtain information from officers of the company, generally in the form of an officers' certificate, with respect to the facts on which counsel is relying, such as the business, property, bank accounts or employees that the corporation has in jurisdictions other than its state of incorporation. The lawyer should also state that the opinion is based upon the officers' certificate and, if requested, attach a copy of the certificate to the opinion. The lawyer should make every effort in negotiating the opinion to agree on the specific jurisdictions that are material to the Company, since materiality is often not an issue upon which a lawyer can render an opinion without substantial factual and legal investigation.

Typical provisions in an opinion with respect to qualifications are as follows:

The Company is duly qualified to do business and is in good standing in the states of _______ and _______.

or

The Company is duly qualified to do business in each state in which it owns or leases any material property or conducts any material business.

or

The Company is duly qualified to do business as a foreign corporation in good standing in all other jurisdictions which require such qualification except to the extent that failure to so qualify would not have a material adverse effect on the Company.

In giving the opinion regarding the corporation's good standing in foreign states, the lawyer can obtain and rely upon certificates from the Secretaries of State of such other jurisdictions. If the company is a foreign corporation, the lawyer may be required to opine that the company is duly qualified to transact intrastate business in California. The lawyer can obtain and rely upon certificates from the California Secretary of State and Franchise Tax Board with respect to the qualification and good standing of foreign corporations.

B. Corporate Power and Corporate Action

A lender, purchaser of corporate stock or other party who proposes to consummate a significant transaction with the corporation is inter-

59. See supra pp. 1020-23 (discussion of officers' certificates).
60. See CAL. CORP. CODE §191 (definition of “transacting intrastate business”); see also id. §208.
ested not only in its corporate status, but also in its capacity, power and authority to enter into the agreement. In addition, in a transaction in which the purpose is to acquire the corporate entity or business of a corporation, the buyer will want assurance that the corporation has the capacity and power to conduct its business.

I. Corporate Power to Conduct Business

A typical opinion provision for corporate power and authorization for the transaction of business is as follows:

The Company has corporate power and authority to own its properties and assets and to carry on its business as it is currently being conducted.

With the adoption of the 1977 General Corporation Law, such opinions will provide little problem with respect to California corporations that do not have limitations specified in their articles. Section 206 of the General Corporation Law permits a corporation, other than a corporation subject to the California Banking Law or a professional corporation, to engage in any business activity. Those corporations subject to the California Banking Law or the laws governing professional corporations may engage in any activity not prohibited by the respective statutes and regulations to which the corporation is subject. Section 207 states that a corporation shall have all the powers of a natural person in carrying out its business activities and lists a number of the powers included in that broad authorization. Corporations organized or governed by other statutes, however, may have restricted powers. In either case, review of the articles is required to confirm the non-existence of any provision restricting corporate power.

The use of the world “authority” in addition to “power” and without the modifier “corporate” immediately preceding it in the phrase “the Company has corporate power and authority . . .” should not be interpreted to mean that the opinion extends to California, federal and local authorizations and approvals. The view of the Committee is that “corporate” modifies both “power” and “authority.” Some lawyers find it advisable, however, either to insert the word “corporate” immediately preceding “authority” or simply to delete “and authority” to avoid any contrary interpretation.

61. Id. §206; see id. §2303 (Section 206 applies to corporations formed prior to 1977 General Corporation Law).
62. Id. § 206.
63. Id. §207.
2. Power and Authority to Enter Into the Agreement

A typical opinion provision is as follows:

The Company has corporate power [and corporate authority] to enter into and perform the agreement.

An opinion that a corporation has corporate power and authority to enter into an agreement is an opinion that the acts contemplated by the agreement would not be *ultra vires*. The discussion above regarding the use of the word "authority," without the modifier "corporate," is equally applicable to this opinion provision. Normally both provisions are combined as follows:

The Company has the corporate power [and corporate authority] to enter into and perform the agreement, to own its properties and assets and to carry on its business as it is currently being conducted.

3. Due Authorization, Execution and Delivery

A common opinion provision is as follows:

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

The opinion regarding due authorization should only be given as substantiated by an appropriate corporate examination, including review of the articles, bylaws and minute books of the corporation. Special attention should be given to verification from the corporate minute book that the directors authorizing the action were duly elected and that the meeting at which the action was authorized was duly convened and held or that the action was otherwise properly taken. Due authorization refers to actions taken by the board of directors and, if necessary, the shareholders. The phrase "duly authorized by all necessary corporate action on the part of the Company" is preferable to "duly authorized" alone, since the latter might imply authorization by a governmental regulatory body or by another third party whose consent may be required.

"Duly executed" refers to the authorization of the officers who have signed the documents on behalf of the corporation, the validity of their signatures (often assumed in the body of the opinion) and the incumbency of the officers executing the document. "Duly delivered" means that the company has delivered the agreement to the other party or parties to the transaction to create a binding contract. In order to give an opinion that a document has been duly delivered, the lawyer should be present at the delivery or be otherwise satisfied as to the due delivery.
C. The Remedies Opinion

That part of an opinion which addresses whether and subject to what limitations an agreement is valid, binding and enforceable is often referred to as the remedies opinion. This opinion is often of foremost importance to the recipient because the opinion addresses whether the rights of the recipient, as stated in the document, will be upheld if litigated.

Numerous exceptions, discussed below, are often added to the following common provision:

The agreement is a valid and binding obligation of the Company, enforceable in accordance with its terms, except . . . .

There is considerable variation among attorneys in the specific form used for this opinion. Some opinions include the term “legal.” Others use only the words “valid and binding” or “legal, valid and binding” and delete any reference to “enforceable.” Others include “enforceable” rather than “enforceable in accordance with its terms.” Some use the prefatory word “legally” with “binding.”

The exact form of the remedies opinion is often dictated by the lawyer for the recipient of the opinion, and the lawyer rendering the opinion may ascribe no particular difference in meaning with respect to which particular form is requested. Other lawyers, however, place very different meanings on the different forms of remedies opinions. The most common formal differences involve the word “enforceable.” Some lawyers delete any reference to “enforceable” in the belief that their opinion does not imply that any remedy is available. Others believe that “valid and binding” and “enforceable” are synonymous and that the deletion of “enforceable” has no significance. Some delete “in accordance with its terms” although they use the term “enforceable.” These lawyers believe that “in accordance with its terms” may mean that specific performance will be available as a remedy.

The consensus of the Committee is that no different meaning should be given to these different forms of remedies opinions and that, whatever the form, the opinion should be given the following general meaning:

64. See generally Babb, Barnes, Gordon & Kjellenberg, supra note 37, at 564-65; Fuld, supra note 3, at 928-32; Fuld, supra note 18, at 1312; New York County Lawyers' Report, supra note 47, at 1914-18.

65. See New York County Lawyers' Report, supra note 47, at 1915, which does not agree with this interpretation. It expresses the view that a “legal, valid and binding” opinion without any stated exceptions is the equivalent of a “legal, valid, binding and enforceable in accordance with its terms” opinion containing both the bankruptcy and equitable principles limitations. Id.

66. See Babb, Barnes, Gordon & Kjellenberg, supra note 37, at 564-65; Fuld, supra note 3, at 930-31; New York County Lawyers' Report, supra note 47, at 1916.
1. The parties to the agreement have the legal capacity or power to enter into the agreement.

2. The agreement has been duly authorized, executed and delivered by both parties.

3. An effective contract has been formed under the law of the applicable jurisdiction. The contract is not invalid in its entirety by reason of a specific statutory prohibition or the "public policy" of the jurisdiction. This does not mean that all provisions of the agreement are effective, such as a covenant to pay interest at a rate in excess of the applicable usury law.

4. Contractual defenses to the entire agreement, such as the statute of frauds, are not available.

5. Some remedy is available if a party to the contract does not comply with its terms generally. This does not mean that specific enforcement is available as a remedy, or that every provision in the agreement, such as the right to accelerate indebtedness in the event of a default, will be upheld by a court.

The Committee is of the view that if the recipient of the opinion has specific concerns relating to the validity of a particular provision or the availability of a particular remedy, such as the effect of the applicable usury law, a specific opinion should be requested with respect to this provision. The recipient may not assume that such matters are covered by the general remedies opinion, whichever form is used.

I. Exceptions to the Remedies Opinion

The remedies opinion commonly contains at least one exception (the "bankruptcy exception"). In recent years the inclusion of exceptions has proliferated, particularly among California lawyers regularly engaged in representing clients in business transactions. In large part, this has been the result of the refusal of the California appellate courts to enforce provisions of loan agreements designed to benefit the lender. The legal principles contained in these decisions could have application to the enforceability of covenants in all types of business contracts, and some lawyers take great care to specifically exclude these matters from their remedies opinion. The consensus of the Committee is that the general remedies opinion assumes the existence of such limitations and exceptions, and the lawyer is not required to make a specific reference to these exceptions.67

The Committee, however, believes that the preferable approach is to include at least the bankruptcy exception and the equitable principles

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67. This is also the conclusion of the New York County Lawyers’ Report, supra note 47, at 1917-1918; see also Babb, Barnes, Gordon & Kjellenberg, supra note 37, at 564.
of limitation until there is some judicial clarification.⁶⁸

The following sections discuss the most common exceptions to the remedies opinion and some specific California problems.

*The Bankruptcy Exception.* The most common exception to the remedies opinion is the bankruptcy exception, which merely recognizes that the enforceability of the obligation is subject to avoidance in a bankruptcy or similar proceeding. This exception is often stated as follows:

... except as the enforceability of the agreement may be subject to or limited by bankruptcy, insolvency, reorganization, arrangement, moratorium or other similar laws relating to or affecting the rights of creditors generally.

Some commentators believe this exception is implicit and need not be expressly provided. The exception, however, is generally included in recognition of its importance, and the Committee recommends its inclusion.

*The Equitable Principles Limitation.* The availability of some remedies, particularly specific performance and injunctive relief, is subject to equitable principles. Courts, particularly in California, have found that certain contractual provisions may involve overreaching or be unconscionable and decline to enforce some or all of those provisions.⁶⁹

Moreover, some California courts have found provisions of various agreements and related documents, otherwise standard throughout the nation and expected by institutional lenders, to violate California public policies rendering the provisions unenforceable unless they are demonstrated under the circumstances to be reasonably necessary for the secured party’s protection.⁷⁰

Although most of these cases have arisen in the context of real estate security agreements, some lawyers believe the rationale of the cases

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⁶⁸ See also New York County Lawyers’ Report, supra note 47, at 1915-17; but cf. Babb, Barnes, Gordon & Kjellenberg, supra note 37, at 564 (bankruptcy exception not necessary, but recommends use of “enforceable” without “in accordance with its terms”).


may apply to other situations as well. Accordingly, many lawyers have
adopted language substantially as follows as an exception to their opin-
ions regarding the enforceability of an agreement:

We advise that a California court may not strictly enforce certain
covenants [or allow acceleration of the maturity of the notes] if it
concludes that such enforcement [or acceleration] would be unrea-
sonable under the then existing circumstances. [“In our opinion,
however, acceleration would be available if an event of default oc-
curs as a result of a material breach of a material covenant contained
in such document” or “However, in our opinion, the failure of a
court to enforce certain covenants [or allow acceleration] will not
materially adversely affect the other benefits or security afforded by
the Documents.”]
The bracketed language is used by some firms to satisfy lenders, while
retaining an equitable principles limitation.

Recently, as the equitable principles limitation has become more
prevalent, the following language has been used as a form of limitation
which encompasses specific performance and injunctive relief:

The enforceability of the Company's obligations under the agree-
ment [and the note] is subject to general principles of equity, regard-
less of whether such enforceability is considered in a proceedings in
equity or at law.\footnote{This language is recommended by the New York
County Lawyers' Report, supra note 47, at 1918. The same limitation in
more specific terms and directly related to California could be
stated in the following language:

The enforceability . . . is subject to limitations imposed by California or federal law
or equitable principles upon the specific enforceability of any of the remedies, covenants
or other provisions of the Documents and upon the availability of injunctive relief or
other equitable remedies, and is also subject to the effect of California court decisions,
invoking statutes or principles of equity, which have held that certain covenants and
provisions of agreements are unenforceable where (i) the breach of such covenants or
provisions imposes restrictions or burdens upon the debtor, including the acceleration of
indebtedness due under debt instruments, and it cannot be demonstrated that the en-
forcement of such restrictions or burdens is reasonably necessary for the protection of the
creditor, or (ii) the creditor's enforcement of such covenants or provisions under the
circumstances would violate the creditor's implied covenant of good faith and fair
dealing.

Civil Code Section 1670.5. Although the standard unconscionability

\footnote{This language is recommended by the New York County Lawyers' Report, supra note 47, at 1918. The same limitation in more specific terms and directly related to California could be stated in the following language:

The enforceability . . . is subject to limitations imposed by California or federal law
or equitable principles upon the specific enforceability of any of the remedies, covenants
or other provisions of the Documents and upon the availability of injunctive relief or
other equitable remedies, and is also subject to the effect of California court decisions,
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provisions imposes restrictions or burdens upon the debtor, including the acceleration of
indebtedness due under debt instruments, and it cannot be demonstrated that the en-
forcement of such restrictions or burdens is reasonably necessary for the protection of the
creditor, or (ii) the creditor's enforcement of such covenants or provisions under the
circumstances would violate the creditor's implied covenant of good faith and fair
dealing.

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provision of the Uniform Commercial Code, Section 2-302, has not been adopted as a part of the California Commercial Code, it was added to the California Civil Code in 1979 as Section 1670.5, and reads as follows:

(a) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(b) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose, and effect to aid the court in making the determination.\(^7\)

This section applies to all contracts in California, not just those subject to the Uniform Commercial Code. Because Section 1670.5 is relatively new and has not been judicially interpreted by the California appellate courts, some California lawyers are disclosing the section by specific limitation in the remedies section of their legal opinions.

The enforceability . . . is subject to the effect of California law, which provides that a court may refuse to enforce, or may limit the application of, a contract or any clause thereof which the court finds as a matter of law to have been unconscionable at the time it was made.

The Committee does not recommend inclusion of this limitation as a standard exception to the opinion. The lawyer may wish to consider its inclusion if an opinion is specifically requested with respect to certain seemingly burdensome contractual provisions.

Noncompetition Agreements. Particular caution should be exercised if the opinion covers the enforceability of a contract containing a "cov- enant-not-to-compete." As a general rule, covenants not to engage in business are considered contracts in restraint of trade and are not enforceable, except when necessary to protect trade secrets.\(^7\) Exceptions are permitted for anyone who sells the goodwill of a business or all of the shares in a corporation, for any shareholder of a corporation which sells all or substantially all of its operating assets together with its goodwill,\(^7\) and for a partner upon dissolution of the partnership for so long

\(^{72}\) CAL. CIV. CODE §1670.5.


\(^{74}\) CAL. BUS. & PROF. CODE §16601.
as the remaining partners or the buyer continues the business. Judicial interpretations of these provisions are numerous, but provide no "bright-line" test in many situations.

**Oral Modifications of Contracts.** Section 1698 of the California Civil Code provides that an oral modification to a contract may be enforceable if the oral modification was performed, notwithstanding an express provision in the contract that amendments could be made only in writing. Some attorneys include an exception to the remedies opinion when the contract states it may be amended only in writing. The Committee does not view such an exception as necessary.

**Penalties, Liquidated Damages, Forfeitures and Increases in Interest Rates.** Certain burdensome contractual provisions will not be enforced by courts. If a court finds a contractual provision to be unreasonable, it may deem the provision to be a penalty and unenforceable. Section 1671 of the California Civil Code was amended, effective July 1, 1978, to make provisions for liquidated damages in commercial contracts valid unless proven unreasonable. This new rule is different from prior law and limited judicial experience with this new provision makes predictions of its ultimate effect difficult.

Contractual provisions that are deemed by a court to provide for a forfeiture must be strictly interpreted against the party who benefits from the forfeiture.

There is some question in California as to the proper analysis of provisions requiring the payment of interest on past due interest. While such a provision may be tested under Civil Code Section 1671, as discussed above this section has had limited judicial review, making predictions difficult. Agreeing on a stated rate of interest on past due interest higher than the rate applied to the principal may be deemed a penalty by a court since such higher rate of interest will not necessarily relate to the damage suffered by the lender. While the lender could argue that such a provision is a bona fide liquidated damage clause, most lenders do not wish to make that argument and thereby waive any other damages they may suffer.

Many loan agreements require a higher rate of interest upon default than was paid to the lender prior to default. Such a provision can be

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75. *Id.* §16602.
78. *Id.* §1442.
analyzed as a forbearance charge, a penalty or late charge, or a liqui-
dated damage provision. California courts have distinguished between
interest and penalty charges, stating that interest is a measure of com-
penstation to which an obligee is entitled while a penalty is punitive in
character. A penalty provision thus operates to compel performance of
an act and becomes effective only in the event of default. Payment is
then required without regard to the actual damages sustained by the
other party and the prevailing interest rate in effect at the time of de-
fault may be substantially lower than the interest rate contained in the
agreement.\textsuperscript{79}

Lawyers rendering opinions covering the enforceability of a contract
in which the foregoing questions exist often include the following type
of exception.

\textcolor{red}{. . . .the agreement may be subject to or limited by the unenforceabil-
ity under certain circumstances of provisions imposing penalties, for-
feitures, late payment charges or an increase in interest rate upon
delinquency in payment or the occurrence of a default.}

\textcolor{red}{Usury. The uncertainties of the usury laws often make it difficult to
render an opinion as to their applicability or consequences in particular
circumstances. For example, under certain conditions courts have held
that the convertibility of a debenture gives rise to additional interest.
Or, a transaction designed as a sale and lease-back or a joint venture
may be held to be a disguised loan transaction, resulting in application
of the usury laws. Another problem may arise when there is a variable
rate of interest. If, for example, the rate of interest charged is linked to
the prime rate and the prime subsequently rises, the interest is usurious
if it goes above the limits of the state law. Similar problems of uncer-
tainty may arise with a contingent interest loan that is conditional on
the occurrence of an event or events in the future. Moreover, the com-
putation of “interest” is often a complex matter, particularly when
“points,” additional charges or any other type of additional considera-
tion is involved. Because of these difficulties, many California lawyers
are reluctant to provide a “usury” opinion. This is particularly so when
any additional consideration to the lender may be present, unless an
exemption from the law itself is clearly applicable. The following ex-
ception is often included:

\textcolor{red}{We express no opinion as to the effect of California or federal laws

\textsuperscript{79. See, e.g., 9 Cal. 3d at 740, 511 P.2d at 1203, 108 Cal. Rptr. at 851 (1973) (a charge for late
payment of loan installment which is measured against unpaid balance of loan is punitive in
character in that it constitutes attempt to coerce timely payment by forfeiture which is not reason-
ably calculated to merely compensate injured lender).}
relating to permissible rates of interest upon the transactions contemplated by the agreement.

Prior to the enactment of Proposition 2 in November 1979, the California Constitution imposed a maximum permissible rate of interest for any loan or forbearance of 7% per annum, although the parties could agree in writing to a rate not in excess of 10%. Large classes of lenders are exempt from these limitations. Proposition 2 continued the 10% maximum for non-exempt lenders with respect to loans for personal, family or household purposes. Loans for the purpose of acquiring or improving a residence are not considered to be for personal, family or household purposes. The maximum permissible rate on all loans subject to Proposition 2 is the higher of 10% per annum or 5% per annum over the rate established by the Federal Reserve Bank of San Francisco on advances to members (known as the "discount rate") on the 25th day of the month preceding the earlier of (1) the date of execution of the contract to make the loan or (2) the date of making the loan. Proposition 2 also added additional exempt lenders and authorized the legislature to designate additional classes of exempt lenders.

The federal government has subsequently preempted all state usury ceilings for loans secured by first liens on residential real property made by specified "federally related" lenders. Unless California enacts a law, prior to April 1, 1983, specifically providing that such federal preemption is not to apply, first lien residential loans by federally related lenders will be permanently exempt from California interest rate limitations. Federal law also now preempts state laws with respect to business loans in excess of $1,000, to the extent such loans would be subject to ceilings lower than 5% per annum in excess of the discount rate, including any surcharge, on ninety-day commercial paper in effect at the Federal Reserve Bank in the Federal Reserve District where the

80. CAL. CONST. art. XV, § 1.
81. Id.
82. See the California Legislature has exempted the following additional classes of lenders from the coverage of the Usury Law: (1) non-California state banks and certain foreign banks, CAL. FIN. CODE §§1716; (2) incorporated insurance companies admitted to sell insurance in California, CAL. INS. CODE §1100.1; (3) a new group of lenders to be known as Consumer Finance Lenders, which will be regulated (including with respect to interest rates) by the Commissioner of Corporations, CAL. FIN. CODE §24451; (4) colleges and universities when making certain faculty residence and student educational expense loans to their faculty members or students, CAL. FIN. CODE §2800, and numerous other special purpose classes. Legislation has been introduced in the California Assembly which would create an exempt class of "Commercial Finance Lenders." Under Assembly Bill 2591, lenders who engage in the business of making business-purpose loans of $5,000 or more generally would be required to apply for and receive a commercial finance lender license from the Commissioner of Corporations before making such loans, and to comply with regulations (not relating to interest rates) of the Commissioner in conducting their commercial lending businesses.

lender is located. This latter provision expires on the earlier of April 1, 1983 or the date on which California enacts a measure stating the federal law should not apply.

The foregoing is a condensed version of the applicable laws relating to usury in California. Lawyers opining on agreements providing for the payment of interest should carefully consider this area since the lender may be subject to both civil and criminal sanctions if the usury limitations are not observed.

**Guarantees.** Sections 2787 through 2855 of the California Civil Code contain provisions that protect, and limit, the obligations of a surety or guarantor. Guarantees given in commercial transactions often purport to waive the protection of these provisions, including that provided by Section 2845 which empowers a surety or guarantor to require the creditor to proceed against the principal or to pursue other remedies not available to the surety or guarantor that would lessen the burden on the surety or guarantor, and it exonerates the surety or guarantor to the extent that he or she is prejudiced if the creditor fails to do so. California courts have imposed some limitations on blanket waivers of all of these statutory provisions. Limited waivers, including those of Section 2845, may be permitted. Rather than express an exception in the opinion, many counsel attempt to have the agreement state that the waiver is made "to the extent permitted by law."

**Guarantees By a Subsidiary.** An issue arises whenever a subsidiary corporation guarantees a loan to or other obligation of its parent. If the subsidiary receives no benefit from the loan, the guarantee may be challenged as made for no consideration or as a fraudulent conveyance under law, or a fraudulent transfer under the Bankruptcy Code, if the subsidiary is insolvent or is rendered insolvent by the making of the guarantee. Attorneys normally require evidence of consideration to the

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84. Id. §86a (Supp. IV 1980).
86. CAL. CIV. CODE §§2787-2855.
88. CAL. CIV. CODE §2845.
subsidiary or limit their opinions with respect to enforceability of the guarantee.

**Indemnity.** California courts have been reluctant to enforce provisions requiring one party to indemnify the other party for loss or damage resulting in part from the second party's wrongful or negligent acts. Such provisions are often strictly interpreted against the party entitled to contractual indemnification or found contrary to public policy. Attorneys are often cautious in rendering an opinion as to the enforceability of an indemnification provision.

**Transfers and Liens on Personal Property Made Without Delivery.** California Civil Code Section 3440 states that, with certain exemptions, transfers or liens on personal property made by one in control or possession of the property are conclusively deemed fraudulent and void against the transferor's creditors unless accompanied by immediate delivery and actual and continued change of possession. While the section does not apply to security interests governed by the Uniform Commercial Code, it does apply to sale-leasebacks of personal property unless the transferor records and publishes a notice of intended transfer.

**Secured Transactions.** While the various questions posed by the Uniform Commercial Code with respect to secured transactions are beyond the scope of this Report, California law contains several provisions outside of that Code which may affect the rights of a secured party in any real estate transaction. Counsel should consider making reference to these provisions in giving an opinion with respect to a loan agreement or security instrument that includes real estate as security for the underlying obligation.

Section 726 of the California Code of Civil Procedure provides that any lawsuit to recover on a debt or other right secured by a mortgage or deed of trust on real or personal property must comply with the provisions of that section. These provisions relate to, and specify the procedures for, the sale of encumbered property, the application of

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proceeds, the rendition in certain cases of a deficiency judgment and other related matters. Failure to comply with the provisions of Section 726 may result in the loss of a lien on real or personal property or the loss of the right to a deficiency judgment.

Section 580d of the California Code of Civil Procedure provides that no deficiency judgment shall be rendered upon a note secured by a deed of trust or mortgage on real property after sale of the real property under the power of sale contained in the deed of trust or mortgage.\textsuperscript{94} Section 2924c of the California Civil Code provides that whenever the maturity of an obligation secured by a deed of trust is accelerated by reason of a default in the payment of interest or of any installment of principal or other sums secured thereby, the trustor and certain other entitled persons have the right to cure this default by paying the entire amount then due.\textsuperscript{95} This right may be exercised within three months of the recording of the notice of default under the deed of trust. The payment made to cure the default reinstates such deed of trust and the obligations secured thereby to the same effect as if such acceleration had not occurred. Finally, Section 580b of the California Code of Civil Procedure provides that no deficiency judgment shall be rendered upon a note secured by a deed of trust or mortgage on real property given to (1) a vendor to secure payment of the balance of the purchase price of the real property, or (2) a lender to secure repayment of a loan which was in fact used to pay all or part of the purchase price of a dwelling for not more than four families, occupied entirely, or in part, by the purchaser.\textsuperscript{96}

\textbf{D. The No-Conflict Opinion}

Two conflicting agreements both may bind the corporation. The conflict may be detrimental to the company and, accordingly, to the bargain the contracting party has negotiated. A typical opinion provision is as follows:

The execution and delivery of the agreement and the performance by the Company of its terms do not conflict with or result in a violation of the Company’s articles of incorporation or bylaws or any judgment, order or decree of any court or arbiter, known to us, of which the Company is a party, and, to our knowledge, do not conflict with and will not constitute a material breach of the terms, conditions or provisions of or constitute a default under any contract, undertaking,

\textsuperscript{95} \textit{Cal. Civ. Code} §2924c.
indenture or other agreement or instrument by which the Company is now bound or to which it is now a party.

Since a lawyer cannot be expected to know the terms of every agreement to which a corporation is a party, it is common for the no-conflict opinion to be limited to agreements within the knowledge of the lawyer. Even in firms with many lawyers, “our knowledge” is probably the knowledge of the entire firm. Nevertheless, it is impractical to expect that the lawyers working on an opinion will always be aware of all other agreements made by a client within the knowledge of some other lawyer in the firm. To the extent possible, it is appropriate to limit the opinion expressly in sole reliance upon a review of documents specified in the introductory paragraphs of the opinion or an accompanying officers’ certificate. If this approach is unacceptable to the other party, the lawyer may attempt to limit knowledge to that of a limited group of lawyers working for the client.

This opinion is often expanded to include a provision that the execution, delivery or performance of the agreement will not “violate any law, rule or regulation having applicability to the Company.” This provision literally applies to all state and local laws and all federal laws. If the opinion is given, the securities laws and antitrust laws are often excluded.

Shareholders’ agreements, voting trust agreements, loan agreements, agreements or laws limiting alienation or use of the company’s assets, settlement agreements, injunction orders and regulated industry laws applicable to the company or its business or assets should be reviewed. The amount of any investigation performed by the lawyer with respect to the no-conflict opinion should be addressed directly in the opinion.

E. Capital Shares

1. Status of Shares

A typical opinion as to capital shares is as follows:

The Company’s authorized capitalization consists of 1,000,000 common shares, of which 500,000 shares are issued and outstanding. The outstanding shares have been duly authorized and validly issued and are fully paid and nonassessable.

97. See supra note 38 and accompanying text.
98. See supra pp. 1020-23.
99. As of January 1, 1977, when a California corporation reacquires its own shares, those shares may no longer become treasury shares but are automatically restored to the status of authorized but unissued shares, unless the articles of incorporation prohibit their reissuance. CAL. CORP. CODE §510(a). Shares that were treasury shares on December 31, 1976, remain treasury shares, unless retired. At least with respect to corporations formed on or after January 1, 1977, it may be surplusage to speak of shares “issued and outstanding” since all shares issued must also be outstanding.
This opinion assumes that the lawyer is passing upon the entire capitalization of the corporation. In some instances, the lawyer will be requested only to render an opinion confirming the number of shares authorized and outstanding and that the shares being issued in the transaction covered by the opinion are "duly authorized, validly issued, fully paid and nonassessable." Less frequently, the recipient will request an opinion covering only the status of the shares to be issued in the transaction.

The authorized number of capital shares can be verified by an examination of the corporation's original articles of incorporation, together with all amendments filed with the California Secretary of State. The number of outstanding shares can be confirmed from a review of the stock record book of the corporation or from a certificate of the corporation's transfer agent in the case of a publicly-held corporation. On occasion, lost share certificates can create a problem with respect to an opinion concerning the number of outstanding shares. If a new share certificate has been issued in substitution for the lost certificate, there remains the possibility that a bona fide purchaser in fact acquired the allegedly lost certificate and that the corporation has a greater number of shares outstanding. Normally, this problem is ignored if the number of shares represented by the lost certificate is de minimus. Otherwise, an exception can be noted in the opinion.

Due Authorization. The concept of due authorization means that the corporation had the power under its articles of incorporation and bylaws to issue the shares of capital stock at the time they were issued and that the corporation adopted proper resolutions and otherwise took necessary corporate action to authorize or ratify the issuance of the shares. Generally, the lawyer can verify from a review of the articles of incorporation and the stock record book (or certificates from the corporation's transfer agent) that there has been no "over-issue" of shares. If previously issued shares have been cancelled, the lawyer must determine whether, under the articles of incorporation, the cancellation resulted in a reduction in the number of authorized shares.100

Most commentators agree that a legal opinion that shares have been "duly authorized" does not include any opinion with respect to the propriety of any proxy statement or other solicitation documentation utilized in connection with an amendment to the articles of incorporation to increase the authorized number of shares that later proves false or misleading in some material respect, making shareholder approval

100. See CAL. CORP. CODE §510(b).
voidable. Unless the adequacy of proxy materials is the subject of specific litigation or otherwise is called particularly to the lawyer's attention, an opinion that shares have been duly authorized does not include an opinion that the proxy materials contain no misstatements or omissions.

Valid Issuance. Shares are "validly issued" if they are duly authorized and issued for proper and sufficient consideration. Shares are not validly issued if they were purportedly issued without proper board or shareholder (as in a merger) approval, in violation of shareholders' preemptive rights, or in excess of the number of shares authorized. The lawyer must determine whether the corporation actually received consideration of a permissible type at the relevant time, which is a factual question. Certificates of the corporation's chief financial officer or stock transfer agent can be used for this purpose. For a privately-held company, the lawyer should also review its stock book records and trace back to its origin each outstanding share certificate on which he is giving an opinion.

The validity of the issuance of shares should not be affected by a failure to comply with the federal securities laws or the California Corporate Securities Law of 1968. These statutes do not make the issuance void, but rather give the purchaser a right to rescind the purchase of the shares or a right to sue for damages. The issuance is not subject to being voided by a regulatory authority or a third party or the issuer itself. There may be a special problem in connection with shares issued prior to the California Corporate Securities Law of 1968, as the prior law stated that the issuance of shares without a permit (if required) was "void."

Section 406 of the California General Corporation Law provides, in effect, that shareholders are not accorded preemptive rights unless the articles of incorporation provide for such rights. The leading secondary authorities state that there may be situations in which directors' fiduciary duties may require them to offer new issues of securities first to existing shareholders before offering them to others, thus creating a

102. See Cal. Corp. Code §409 (defines the various types of legal consideration for the issuance of shares by California corporations).
103. The California courts, however, have interpreted "void" to mean "voidable" by the purchaser, and have also permitted the issuer to assert an "in pari delicto" defense in some situations. See Marsh & Volk, Practice Under the California Securities Laws §14.01(1)(b) (1981). The California Insurance Code still contains the "void" concept for securities issued by issuers, both domestic and foreign. Cal. Ins. Code §831.
shareholders' right referred to as "quasi-preemptive right." A lawyer should not be required to evaluate the circumstances to judge whether or not directors are required to offer new issues of securities to existing shareholders in the absence of express preemptive rights provisions in the articles, and an opinion that the shares have been "validly issued" should not be interpreted to include such a judgment.

The lawyer should also consider Section 409(e) of the California General Corporation Law in any instance in which shares have been or will be issued for consideration other than cash. That section requires that the corporation's board of directors "state by resolution its determination of the fair value to the corporation in monetary terms" of any such consideration. It is uncertain whether a failure to comply with this requirement affects the validity of the issuance. It would appear, however, that any such defect could be cured by a subsequent board resolution complying with this provision and ratifying the issuance of the shares.

Consideration and Assessability. Shares have been "fully paid" if the consideration required by the corporate acts authorizing the issuance has been received in full and if such consideration was legally sufficient under the articles and applicable law. For California corporations, the type of consideration for which shares may be issued is set forth in Section 409 of the General Corporation Law. That section specifically excludes future services or promissory notes of the purchaser (unless adequately secured by collateral other than the shares acquired or unless permitted by Section 408 of the General Corporation Law dealing with employee stock purchase plans).

Shares which are "fully paid" are nonassessable. There may be some uncertainty with respect to the "fully paid" status of shares issued by certain California corporations at less than their par value. Under Section 1110 of the California Corporations Code in effect until the General Corporation Law became effective on January 1, 1977, the value received by a corporation for the issuance of shares having par value must have been at least equal to the par value, with exceptions not applicable here. The General Corporation Law has eliminated any reference to par value (except where required by other statute or regulation). Corporations existing prior to the effective-

105. CAL. CORP. CODE §409(e).
106. Id. §409(a)(1).
107. Id. §409(a)(1).
108. Id. §205.
ness of the General Corporation Law are not required to amend their articles to eliminate par value, and the effect of the issuance of par value shares by such corporations, which have not amended their articles, for a lesser value is not clear.

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

The General Corporation Law changes this treatment by subjecting "distributions to shareholders" to the provisions of Chapter 5 of the General Corporation Law.109 Section 166 of the General Corporation Law expressly excludes stock dividends from the definition of "distributions to shareholders."110 Section 114 requires that generally accepted accounting principles be used in the preparation and determination of financial statements and items, and those principles may require transfers from retained earnings.111 Nevertheless, those principles do not affect the legality of the issuance, and the absence of retained earnings or the failure to make transfers in accordance with generally accepted accounting principles no longer raises a question that shares issued as stock dividends are not fully paid.

2. Transfer of Shares

A typical opinion as to the transfer of shares is as follows:

Upon payment for, and delivery of the Shares in accordance with the terms of the Agreement, and assuming the Purchaser is acquiring the Shares in good faith without notice of any adverse claim, the Purchaser will be the owner of the Shares, free and clear of any adverse claim.

This opinion follows the terminology used in Division 8 of the California Commercial Code, which defines the rights of ownership held by

109. Id. §§500-511. Section 188 of the General Corporation Law defines a stock split as "a pro rata division, otherwise than by a share dividend, of all the outstanding shares. . . ." Id. §188. Thus stock splits are also not subjected to the provisions of Chapter 5 of the General Corporation Law.

110. CAL. CORP. CODE §166.

111. Id. §114.
A purchaser of securities. A purchaser of corporate shares often requests an opinion that he or she is receiving "good and marketable title" to the shares. "Good and marketable" is not a term used in the California General Corporation Law or the California Commercial Code, and the marketability of the shares will often depend upon the nature of the transaction in which they are subsequently sold and the sophistication and financial means of the purchaser.

3. Distributions to Shareholders

In general, a lawyer should be reluctant to render an unqualified legal opinion with respect to compliance with the requirements of Chapter 5 of the General Corporation Law on distributions to shareholders, such as cash or property dividends or the repurchase of shares. Compliance is essentially a factual matter based on a corporation's financial position and, if applicable, the provisions of its preferred share contracts. The recipient shareholders should be satisfied with a certificate from the chief financial officer.

The opinion may deal with the validity and enforceability of a corporation's agreement to repurchase its shares or its agreement to make periodic installment payments of the purchase price for shares already purchased. Even if redeemable shares are involved, the enforceability of such provisions are subject to compliance with the requirements of Chapter 5. If installment payments are involved, the tests set forth in Section 500 of the General Corporation Law must be satisfied at the time each payment is made unless a "negotiable debt security" is issued in payment for the shares.

Any opinion covering the validity and enforceability of such a purchase agreement or installment obligation should contain an exception to the following effect:

. . . except as the purchase of [payment of the purchase price for] the Company's shares pursuant to the Agreement is subject to Sections 500 through 506 of the California General Corporation Law.

Selling shareholders may also want a legal opinion as to the time that a distribution will be deemed to occur, pursuant to Section 166 of the General Corporation Law, in connection with the installment repurchase of shares. When the Chapter 5 tests appear to be satisfied at the outset, recipient shareholders will want assurance that they are receiving "negotiable debt securities," so that subsequent payments will not be subject to the Chapter 5 rules. On the other hand, if the entire

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112. See CAL. COM. CODE §§8301-8320.
113. CAL. CORP. CODE §§500-510.
114. Id. §166. "Negotiable debt security" is defined in CAL. COM. CODE §8102(1).
purchase price will not satisfy the Chapter 5 tests at the outset, the recipient shareholders may request assurance that they are not receiving "negotiable debt securities" and that the test of compliance with Section 500 will be made at the time of payment of each installment under the agreement.

4. Selected Blue Sky Problems

Corporations Code Section 25102(h)—The "Ten or Less Shareholders" Exemption. An often relied upon exemption from the qualification requirements of the California Securities Law of 1968 for the issuance of securities is that provided by Section 25102(h) of the California Corporations Code.\(^1\) That section exempts the offer or sale of voting common stock when immediately after the issuance there will be only one class of stock outstanding, beneficially owned by no more than ten persons, and other requirements are met with respect to the form of offer and sale and the consideration received. To comply, a notice of issuance must be filed with the California Commissioner of Corporations on which a member of the California Bar must render an opinion that the exemption is available.

The opinion which California counsel must provide is as follows:

On the basis of facts stated in the foregoing Notice and other information, including representations as to the type of consideration received or to be received, supplied to me by officials and shareholders of the issuer and by proposed issuees, it is my opinion that the exemption from qualification with the Commissioner of Corporations provided by Subdivision (h) of Section 25102 of the California Corporations Code is available for the offer and sale of the shares referred to in this Notice.

The exemption provided by Section 25102(h) is available only when shares are issued for proper consideration. If there is only to be one shareholder after the issuance, any legal consideration is acceptable. If there is to be more than one shareholder after the proposed issuance, only cash, cancellation of indebtedness for money borrowed, or assets of an existing business enterprise which has operated for a period of not less than one year qualify (and then only in specified circumstances).

The legal opinion states that the lawyer has received representations as to the type of consideration received or to be received by the company and implies that those representations were made by each of the proposed issuees and the principal officers and any existing sharehold-

\(^1\) CAL. CORP. CODE §25102(h).
ers of the issuer. The lawyer will normally require that these representations are made in writing.

There is a special problem in the use of this exemption for the issuance of shares by a statutory "close corporation." Statutory close corporations are permitted to vary the normal rules for internal governance by the use of shareholders' agreements, that may vary rights, duties, obligations and preferences between shareholders. The California Commissioner of Corporations has expressed concern that shareholders' agreements altering traditional corporate governance rules may undermine the safeguards that underpin the exemption provided by Section 25102(h). This concern was incorporated in Rule 260.102.4(b) which states that a corporation does not have "only one class of stock" if there exists or is presently intended to be executed a shareholders' agreement pursuant to which any of the rights, preferences, privileges or restrictions upon shares, as enumerated in Section 25103(e), are or would be modified in a manner not applicable to all outstanding shares. The notice which must be filed with the Commissioner was also modified to require the issuer to state to the best of its knowledge that its shareholders had not entered into such a shareholders' agreement. Since one of the primary purposes for utilizing a statutory close corporation is to alter shareholders' rights, lawyers should use great care in considering the availability of the exemption provided by Section 25102(h) for such a corporation.

Corporations Code Section 25102(f)—The "Non-Public Offering” Exemption. In 1981 California enacted a new exemption from the qualification requirements of the Corporate Securities Law of 1968 for the issuances of securities that meet the requirements of Section 25102(f) of the California Corporations Code. In general this section exempts the sale of securities to qualified purchasers in a transaction in which no more than 35 purchasers are involved, each of whom represents that the securities are being acquired for investment, and in which no advertising is used in the offer and sale. Unlike the exemption provided under Section 25102(h) of the Corporations Code, no opinion of counsel is required in order to comply with the exemption. The issuer or the purchasers of the shares, however, may request an opinion that the requirements of this section have been satisfied.

116. See id. §158.
118. 10 CAL. ADMIN. CODE §260.102.4(b) (1982); see also CAL. CORP. CODE §25103(e).
119. CAL. CORP. CODE §25102(f).
120. The transaction must also satisfy the requirements of some exemption under the Securities Act of 1933, as amended. The principal nonpublic offering exemption is provided in Section
A principal requirement for compliance with this exemption is that each purchaser must either have a preexisting business or personal relationship with the issuer of the security or have sufficient business or financial experience to be reasonably assumed to have the capacity to protect his or her own interests in connection with the transaction. This involves a factual determination that each purchaser satisfies one of the alternative requirements. The lawyer rendering an opinion that the requirements of this exemption have been satisfied will normally require that each purchaser sign a factual certificate detailing his or her relationship to the issuer or sophistication in financial or business transactions and representing generally his or her compliance with the purchaser requirements of the exemption. The lawyer may also obtain additional factual information on the basis of information furnished in the purchaser's certificate and will also normally obtain a factual certificate from the issuer covering the various elements of the exemption. The lawyer will normally limit the opinion to reliance on the accuracy of the factual representations made by the purchasers and the issuer.

F. Quasi-Foreign Corporation

Section 2115 of the General Corporation Law provides that a corporation incorporated under the laws of a jurisdiction other than California, but which has more than one-half of its “outstanding voting securities” held of record by persons having addresses in California and which has an average of its property, payroll and sales factors (based on the factors used in determining its income allocable to California on its franchise tax returns) in excess of fifty percent, is governed by specific sections of the General Corporation Law (to the exclusion of the law of the jurisdiction in which it is incorporated).\textsuperscript{121} Section 2115 expressly does not apply to companies with shares listed on certain national securities exchanges or to their wholly owned subsidiaries. Sections purporting to apply to qualifying foreign corporations include those providing for the right to cumulate votes at any election of directors, as well as those governing distributions to shareholders and reorganizations, including sales of assets and mergers.

Commentators have questioned the constitutionality of Section 2115.\textsuperscript{122} In addition, Section 2115 has been the subject of considerable litigation, both in California and Delaware, which has produced con-
Conflicting results at the trial court level, but, there were, no reported appellate decisions. However, in December of 1982, the California Court of Appeal in *Wilson v. Louisiana Pacific Resources, Inc.*, 123 held there was no constitutional obstacle to enforcing the provisions of Section 2115. Although the specific provisions of California law involved in the case were limited to subdivisions (a), (b) and (c) of Section 708 (cumulative voting), the application of the case appears to be broader than that. 124

The uncertain applicability of Section 2115 to qualifying corporations poses special problems for counsel. Whenever an opinion is required with respect to action involving a corporation's board of directors, a conflict between California's cumulative voting requirements and the charter documents and law of the jurisdiction of incorporation may place the validity of the directors' action in doubt. For instance, if the law of incorporation and the charter documents do not provide for cumulative voting and the shareholders are denied the right to elect the directors pursuant to cumulative voting, is action taken by a board of directors constituted in apparent violation of Section 2115 valid?

Another potential area of conflict concerns different limitations on distributions to shareholders. There are cases in which the General Corporation Law prohibits dividends lawful under the laws of other jurisdictions, such as Delaware. On the other hand, the laws of other jurisdictions may prohibit dividends that are quite proper under California's new approach. Unless the limitations are satisfied with respect to both the jurisdiction of incorporation and California, counsel may be unable to provide an unqualified opinion as to the propriety of the distribution (or the test to be used) in the absence of the lawyer's further opinion on the applicability, and ultimate constitutionality, of Section 2115.

**G. Absence of Litigation**

The lawyer will often be requested to render an opinion to the effect that:

To our knowledge, there are no [material] pending or threatened lawsuits or claims against the Company [except as set forth in a schedule to the Agreement].

This opinion, without the word "material," is principally a factual representation by the lawyer that neither the lawyer nor members of his

or her firm know of any undisclosed pending or threatened claims against the client. In general, the lawyer should not be an additional warrantor of the facts, and the recipient of the opinion should rely on the company's representations in this regard. Many lawyers, however, believe that a lawyer representing a client on a regular basis may have some special knowledge of potential claims against his or her client. Therefore, this opinion is often given even though it relates principally to factual matters.

The lawyer will generally obtain a factual certificate from the client concerning matters in litigation and the absence of any threatened claims, and may examine certain of the company's files in which pending or threatened claims would normally be recorded. Some lawyers also examine the court records in the principal place of business of the company to confirm that no lawsuits are on file that have not yet been served. The Committee is of the view that such an examination is not necessary for purposes of rendering this opinion. If the lawyer is part of a law firm, he or she will normally canvass the other lawyers in the firm to confirm their knowledge of claims pending or threatened against the company. These are typically the same procedures followed by lawyers in rendering their normal year-end negative assurances to their clients' auditors.

If the opinion, in effect, requests that the lawyer distinguish "material" from nonmaterial litigation, there are additional problems. The lawyer may thereby be placed in a position of evaluating the probable outcome of certain litigation, the range of loss if the client is unsuccessful and whether such loss would be material to the financial condition or operations of the company. These factors are often beyond the ability of the lawyer because of the nature or stage of the litigation or the legal uncertainties involved. The Committee believes that the lawyer should not be required to make this type of evaluation in the normal opinion rendered in connection with the completion of a business transaction. If the recipient of the opinion has concerns with respect to a particular matter in litigation, this should be covered by a separate narrative evaluation.

H. Title to and Transfer of Assets

The lawyer will occasionally be asked to render an opinion that the company has "good and marketable title" or "good and valid title" to its assets. The Committee is of the view that the lawyer should almost
never render such an opinion as to the title to assets. For California
real estate, the recipient should be satisfied with a title insurance policy
and, in general, it is nearly impossible for the lawyer to effectively as-
certain the status of title to most forms of personal property. Title is
normally dependent upon unrecorded bills of sale from one purchaser
to another. For any substantial business, it is not economically or le-
gally practical to trace the origin of particular items of personal
property.

Sometimes the lawyer will be asked to give an opinion that the com-
pany has transferred title to certain assets to a buyer. This opinion can
be given if properly phrased in a quitclaim form (e.g., “the Company
has sold, transferred and conveyed all of its right, title and interest in
and to the specified assets to Buyer”). This opinion does not affirm that
the company has any title, merely that it has effectively conveyed what
it owns.

The buyer may be satisfied with the seller’s warranty with respect to
the ownership of personal property, but may request that the lawyer
give an opinion that the buyer will acquire these assets free and clear of
all or certain types of liens. The lawyer can ascertain the existence of
certain liens on California personal property by obtaining a certificate
from the Secretary of State with respect to the existence of financing
statements and certain other liens that are perfected by filing with the
Secretary of State. This certificate, however, will be prepared as of a
date prior to the consummation of the transaction, and the lawyer
should limit the opinion to the date of the certificate and normally
render the opinion solely in reliance on the certificate. There are other
liens or priorities that may be created other than by filing with the Sec-
retary of State (or may have been created by a prior owner by such
filing), and a detailed legal review is often necessary if the opinion cov-
ers liens other than those perfected by such filing.

If the transaction involves a transfer of a substantial portion of the
seller’s business assets, there are other matters that the lawyer must
consider. If the transfer is subject to the provisions of the California
Uniform Commercial Code dealing with bulk transfers, the buyer takes
subject to the rights of prior creditors of the seller unless certain notice

126. See supra p. 1052 (discussion of rendering opinions on corporate share transfers).
127. See CAL. COM. CODE §9401(o) (U.C.C. filings); CAL. GOV’T CODE §§7150-7164 (new
state tax liens); CAL. CIV. PROC. CODE §§488.340 (certain attachment liens), 2101 (certain federal
liens).
128. See, e.g., CAL. COM. CODE §9302, (exceptions to U.C.C. perfection by filing); CAL. GOV’T
CODE §7190 (state tax liens created prior to July 1, 1978); CAL. REV. & TAX CODE §§2191.3-2191.6
(county tax collector liens on all property of taxpayer in the county).
provisions are satisfied. Moreover, the buyer may also be subject to certain tort liabilities of the seller, even though the agreement expressly provides that the buyer assumes no liabilities of the seller.

VI. CONCLUSION

The Committee has endeavored to provide some general assistance to California lawyers in the preparation of the legal opinion in a business transaction. For the lawyer not regularly engaged in such transactions, this commentary hopefully will provide a greater understanding of the function of the opinion, its various components, procedures which may be followed in rendering the opinion and some guidelines as to matters normally appropriate for inclusion in the opinion. For the experienced business lawyer, the Committee has attempted to provide a readily available reference and checklist for issues and problems routinely encountered in rendering such opinions.

The members of the Committee are hopeful that this Report will perhaps result in a greater understanding, uniformity and simplicity of opinions rendered by California lawyers.

129. CAL. COM. CODE §§6101-6111.
Bibliography

LEGAL OPINIONS

Legal Opinions in Business Transactions

1. Legal Opinions Given in Corporate Transactions—A Program by the Committee on Developments in Business Financing, 33 BUS. LAW. 2389 (1978).


**Responses to Audit Inquiries**


**Tax Shelter Opinions**


**Securities Law Opinions**


APPENDIX A
Attorneys' Professional Responsibilities

TABLE OF CALIFORNIA CASES

*Smith v. Lewis*, 13 Cal. 3d 349, 118 Cal. Rptr. 621 (1975).
*Estate of Kruger*, 130 Cal. 621, 63 P. 31 (1900).

APPENDIX B

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