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Trends in Private Counsel M&A Transactions: Target Counsel Legal Opinions

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In all types of business transactions, the parties rely heavily on their own counsel to negotiate business and legal points, and to draft the transaction documentation to reflect the agreed upon terms. In addition to relying on due diligence on the representations and warranties contained in the transaction document, often one party will require a written legal opinion from counsel to another party as a condition to the closing of the transaction.

Third party legal opinions are more common in certain types of transactions than others. For example, in financial transactions (e.g., bank financings), these formal opinions have been described as "a fixture of the American legal scene." [ii] In private company M&A transactions, it is most common for the buyer to require a legal opinion from counsel to the target company or selling equity holders. [iii] However, legal opinions requested from the buyer's counsel seem to be used less frequently. [iv] This article examines the potential reason for the difference.

Common Scope of Target Counsel Legal Opinions

Third party legal opinions do not come without significant legal time and resulting expense. Opining lawyers work hard to negotiate a legal opinion with stated limitations to minimize the possibility of a claim against the opining law firm. These limitations may include keeping substantive statements as narrow as possible, relying on certifications and other statements by the client and others, defining and limiting the materials reviewed, and stating exceptions and exclusions broadly. In addition, the opining law firm invests a significant amount of time reviewing all of the materials underlying an opinion, and many firms require multiple-partner or opinion committee review and approval of any written opinion letters.

Theoretically a buyer could request that any particular matter be addressed in a target counsel opinion. As a practical matter, however, there are fairly well-established customs and practices for these opinions, including the required topics, specific language used, documents reviewed, and customary qualifiers, exceptions, and assumptions. In recent years, the scope of "customary practice" has been the subject of resources developed by leading practitioners and professional

organizations such as the American Bar Association ("ABA"). Further, some of these organizations have developed and published proposed "model" opinions, [v] which have gained varying degrees of acceptance.

In a private M&A transaction, a target counsel legal opinion is most appropriate for legal issues best assessed, or easily verified, by target counsel. For example, because target's counsel is typically involved in preparing the necessary shareholder and director votes and resolutions approving the transaction (and in determining whether related by-law or other provisions regarding quorum, meeting notices, etc., have been followed) that counsel is in the best position to opine that the transaction has been duly authorized. Other topics often found in target counsel legal opinions include: [vi]

- good standing and valid existence of the target;
- due authorization, execution, and delivery of transaction documents;
- absence of conflict between transaction documents and the target's charter document and other contracts, or applicable laws;
- absence of governmental filings or consents as to the target entering into and performing the transaction documents and completing the transaction;
- absence of litigation against the target and relating to the M&A transaction;
- authorized and issued and outstanding capital stock (higher relevance in a stock purchase context); and
- the *effect* of transfer of stock (in a stock purchase context). This last opinion often is the subject of confusion. If drafted properly, it should not state that the buyer has acquired good and marketable title to the stock (though a seller representation and warranty may in fact state that in the transaction documents), but rather it should reference the rights or status of the buyer with respect to the stock under applicable state law—typically the rights that the buyer obtains under the Uniform Commercial Code upon delivery and possession of properly endorsed stock certificates. [vii]

However, target counsel legal opinions typically do not cover matters that the target's counsel cannot reasonably verify (e.g., issues impacted by the legal status or actions of the buyer) or purely factual matters or issues. [viii] The buyer may insist on a target counsel legal opinion in an effort to prevent the target from later taking a position inconsistent with the opinion letter or to restrain the opining lawyer from representing the target in any claim at odds with the opinion. [ix] However, while the opining lawyer may be unwilling or unable to represent the target in such circumstances, it seems unlikely that the target itself would be prevented from asserting a defense even if inconsistent with the legal opinion. [x]

Some buyers believe that a target counsel opinion can serve as a backstop or insurance for its own diligence lapses or for the target's own representations and warranties as to the matters covered in the opinion. However, using a third party opinion as a backstop to due diligence may be of limited utility because opinion letters are typically much more narrow in scope than the corresponding target representations and warranties. Moreover, while lawyers can be held responsible for

intentional misconduct, recklessness, or negligence, they usually cannot be held liable "merely for being wrong"—as opposed to a target's liability for breach of representation or warranty (which generally does not depend on state of mind or intent in M&A transaction documents): being "merely wrong" is enough in that context). [xi]

Trends in Target Company Legal Opinions

Every other year since 2005 the ABA has released its Private Target Mergers and Acquisitions Deal Point Studies (the "ABA studies"). [xii] The ABA studies examine purchase agreements of publicly available transactions involving private companies that occurred in the year prior to each study (and in the case of the 2017 study, including the first half of 2017). These transactions range in size but are generally considered as within the "middle market" for M&A transactions; the average transaction value within the 2017 study was $176.3 million.

According to the 2017 ABA study, only 7% of the agreements included the delivery of a target counsel legal opinion as a closing condition. This continues a sharp decline in the requirement for target counsel legal opinions evidenced in prior studies – dropping from 73% in 2005 to 11% in 2015. Lawyers are generally slow to change their ways, making this decline quite significant when compared to other deal points covered in the ABA studies—many of which are either holding steady, bouncing up and down with no apparent trend, or are trending at a slower pace.

Why the Trend?

The ABA studies report how deal points are being resolved in M&A documents, they do not explain *why* some deal points may evolve over time. At present, there is no way to extrapolate from the ABA studies the many considerations that go into the decision making with respect to any given M&A deal point. However, it appears that M&A lawyers and their clients are concluding on an increasing basis that the benefits of a target counsel legal opinion simply do not outweigh the costs (both in time and expense).

The following factors may be influencing the cost-benefit analysis as to target counsel legal opinions:

- a target counsel legal opinion is a poor substitute for thorough due diligence, appropriate representations and warranties, and adequate remedies for claims;
- the common use in these opinions of qualifiers (e.g., knowledge qualifiers tied to a small group of named attorneys in the firm giving the opinion), reliance on certificates from the target, and a narrow scope of documents reviewed, makes the opinion less meaningful;
- there is a relatively small universe of legal topics that target counsel is in a materially better or more efficient position to determine, such as the target's good standing. However, the buyer should be able to readily determine that from a good standing certificate issued by the state of formation;
- even if the buyer is requesting an opinion arising under another state's laws when that state's laws control the interpretation of the M&A documentation (e.g., as to enforceability),

it is often more advisable for the buyer to seek local counsel to advise on such issues rather than relying on a third party opinion letter; and

- the post-recession pressure on legal fees has sharpened the focus on the relationship between legal process and actual value to the client, and given the costs of drafting and negotiating a typically narrow third party legal opinion, that particular document may be making the cut less often. [xiii]

This does not mean that third party legal opinions are always inappropriate or useless. There may be circumstances where such an opinion is warranted and of real benefit to the buyer. For example, if the target has no prior experience in M&A transactions (e.g., a family business being sold by the family members) but has competent, long-standing counsel, the buyer understandably may want the additional comfort that a target counsel legal opinion may offer, recognizing that experienced opining counsel would likely apply a rigorous diligence standard to the statements within his or her opinion. [xiv] The same reasoning may apply if the buyer has general concerns as to the overall quality of the target's information produced in response to the buyer's due diligence inquiries.

Conclusion

Assuming that the ABA studies reasonably reflect general practice in private company M&A transactions, it appears that more practitioners are agreeing not to require a target legal counsel opinion as a condition to the buyer's obligation to close the transaction. As is always the case, however, the specific facts and circumstances on the ground, as opposed to any particular market study, should govern how practitioners on both sides approach and work through this issue.

[i] Daniel Avery is a Director, and Tim Carter is an Associate, in the Business Law Group at Goulston & Storrs, in Boston, Massachusetts. Mr. Avery is a member of the ABA's working group which published the 2017 ABA private company M&A deal points study. This article is based on, and updates, the article of the same name co-authored by Mr. Avery and Daniel H. Wientraub, published in the 45 SRLR 996 edition of the Bloomberg BNA Securities Regulation and Law Report (May 27, 2013). This article is one of a series of over 20 articles co-authored by Mr. Avery looking at trends in private company M&A deal points. The series is currently being updated to reflect the 2017 ABA private company study and will be published throughout 2018. The articles can be found on Goulston & Storrs' "What's Market" web page at https://www.goulstonstorrs.com/whats-market/ and on Bloomberg Law at https://www.bloomberglaw.com/page/infocus_dealpoints.

[ii] Donald W. Glazer, Scott FitzGibbon and Steven O. Weise, *Glazer and Fitzgibbon on Legal Opinions*§1.1 (Wolters Kluwer 3d ed. 2008 & Supp. 2012) ("*Glazer and Fitzgibbon*").

[iii] Note that within this article we use the term "target counsel" interchangeably with "sellers' counsel" or "shareholder counsel," as appropriate given the context—i.e., in an asset purchase transaction, the target would be selling assets and as such the opinion would likely be requested of counsel to the target, as opposed to a stock purchase transaction, in which the relevant opinion

letter may be requested of counsel to the selling shareholders. Similarly, we use the term "target" to include the concepts of "sellers" or "shareholders" as the context would require.

[iv] This article looks at the prevalence of third party legal opinions in U.S. private company M&A transactions only; it does not examine third party legal opinions in other types of transactions such as public company M&A transactions.

[v] *See* A.B.A, Model Asset Purchase Agreement ("Model APA"), Ex. 7.4(a) Opinion of Counsel to Seller (2001).

[vi] *See, e.g.,id.*

[vii] Note, the topics identified in this article refer to third party legal opinions in a corporate M&A context. A buyer may, depending upon the specific circumstances, require an opinion to cover additional specific issues, including as to patents, tax, and litigation generally (i.e., beyond claims relating to the transaction itself).

[viii] *See, e.g., Model APA*, Ex. 7.4(a) Opinion of Counsel to Seller, Vol. 2 pp. 67.

[ix] *See Glazer and Fitzgibbon, supra* note 2,at p. 14.

[x] *See id*.

[xi] *See id.,*at p. 16.

[xii] A project of the M&A Market Trends Subcommittee of the Mergers & Acquisitions Committee of the ABA's Business Law Section. References to years within the charts referenced in this article are to the respective years of the ABA studies.

[xiii] Of course, this does not explain why in different transactional settings third party legal opinions are still regularly (and consistently) required, as the same rationale would presumably apply to other types of transactions. For example, these opinions are still a common part of bank debt financing transactions.

[xiv] *See Glazer and Fitzgibbon, supra*note 2 at Appx. 8A (ABA Model M&A Opinion) ("[n]otwithstanding the decline in closing opinions in private target acquisitions, many buyers still see value in obtaining an opinion regarding the sellers and the target…")