

**Certification Drag: The Opinion Puzzle  
and Other Transactional Curiosities**  
(forthcoming in 33 *J. of Corporation Law* (2007))

**Jonathan M. Barnett**

**USC Center in Law, Economics and Organization  
Research Paper No. C07-10**



**CENTER IN LAW, ECONOMICS  
AND ORGANIZATION  
RESEARCH PAPER SERIES**

University of Southern California Law School  
Los Angeles, CA 90089-0071

*This paper can be downloaded without charge from the Social Science Research Network  
electronic library at <http://ssrn.com/abstract=1012961>*

**CERTIFICATION DRAG:  
THE OPINION PUZZLE AND OTHER TRANSACTIONAL CURIOSITIES**

**Jonathan M. Barnett\***

**(Forthcoming, *Journal of Corporation Law*, Vol. 33 (2007))**

**TABLE OF CONTENTS**

<b>Introduction</b>	<b>3</b>
I. Certification Revisited	<b>9</b>
A. Theory	<b>9</b>
B. Evidence	<b>12</b>
II. Identifying the Opinion Puzzle	<b>17</b>
A. Content	<b>18</b>
B. Costs	<b>22</b>
C. Value	<b>23</b>
1. “Obvious” Limiting Factors	<b>24</b>
2. Legal Exposure	<b>26</b>
3. Reputational Exposure	<b>34</b>
D. Evaluation: The Puzzle Emerges	<b>40</b>
III. Solving the Opinion Puzzle	<b>44</b>
A. Demand-Side Incentives	<b>46</b>
B. Supply-Side Incentives	<b>51</b>
IV. Fixing the Opinion Puzzle	<b>55</b>
A. Law Firms	<b>56</b>
B. Collective Organizations	<b>58</b>
C. Insurance	<b>59</b>
D. Obstacles to Self-Correction	<b>60</b>
V. Some More Puzzles: Applications and Extensions	<b>62</b>
A. Credit Ratings	<b>65</b>
B. Fairness Opinions	<b>68</b>
C. Contractual Boilerplate	<b>71</b>
<b>Conclusion</b>	<b>74</b>

Financial markets are populated by a host of reputable intermediaries, including law firms, auditors, underwriters, investment banks and credit rating agencies, which provide various stamps of approval attesting to costly-to-verify characteristics of the relevant asset. The law-and-economics literature has typically observed that these “certification intermediaries” have low rational incentives to endanger hard-won reputational capital by acting fraudulently or even negligently and therefore are generally viewed as enhancing market efficiency by mitigating informational asymmetries that may otherwise distort or even frustrate mutually beneficial transactions.<sup>1</sup> But it has largely gone unrecognized that this “happy” efficiency story has found at best mixed and often inconclusive empirical support in the case of certain commonly used certification instruments in the financial and other markets.<sup>2</sup> Nor, as *has* been increasingly recognized in the wake of Enron and other contemporary scandals (including by some of its original exponents<sup>3</sup>), does this unqualified “certification thesis”<sup>4</sup> sit comfortably with the

---

\* Asst. Prof., Univ. of Southern California, Gould School of Law. I am grateful for helpful comments from Dan Klerman, Donald Langevoort, Shmuel Leshem, Daria Roithmayr, Peter Siegelman and Bill Simon and enlightening discussions with Gillian Hadfield, Matthew Spitzer, participants at the 2007 Stanford/Yale Junior Faculty Forum, and faculty members at Fordham Univ. School of Law and the Univ. of Texas at Austin School of Law. Appreciation to several anonymous legal and insurance practitioners for informative conversations and the library staff at the USC School of Law and Jacob Dy-Johnson for valuable research assistance. All errors are mine.

<sup>1</sup> See *infra* Part I.A.

<sup>2</sup> See *infra* Part I.B.

<sup>3</sup> See Ronald J. Gilson & Reinier Kraakman, *The Mechanisms of Market Efficiency Twenty Years Later: The Hindsight Bias*, 28 J. CORP. L. 715, 736-37 (2003) (stating that “recent scandals demonstrate that we . . . were too sanguine about the role of the institutions that we termed ‘reputational intermediaries’—the established investment banks, commercial banks, accounting firms and law firms”); Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 J. CORP. L. 1, 30 (2002) (noting that, in light of Arthur Andersen scandal, reputational pressures and even stiff regulatory penalties apparently are insufficient to restrain fraudulent auditor behavior).

<sup>4</sup> A closely equivalent claim is the “reputational intermediary” thesis, which captures some but not all of the practices that fall under the rubric of the “certification thesis” insofar as the latter encompasses non-reputational bonding mechanisms (e.g., a warranty or other contractual guarantee backed up by judicial enforcement).

historical and recent recurrence of fraudulent and similar conduct even in sophisticated business environments monitored by a large population of prestigious (and expensive) intermediaries.<sup>5</sup>

In this Article, I tell a “not-so-happy” story of certification intermediaries that anticipates in part these otherwise curious failures of the financial markets to satisfy the sanguine expectations of the standard certification thesis. Specifically, I identify a perverse “two-sided” incentive structure, which, through a combination of agency-cost and adverse-selection effects, sustains minimally informative but non-cost-justified certification practices even in sophisticated markets, thereby imposing a levy on business transactions—or, as referenced in this Article’s title, a “certification drag”—without generating commensurate benefits in the form of improved transaction pricing or structuring. To oversimplify only slightly: these certification instruments cost *something* but often appear to say *almost nothing* (or more precisely, almost nothing *new*). Contrary to the standard account (and without assuming any of the “usual suspects” behind market failure, as identified below), non-cost-justified bonding practices that generally do little to facilitate efficient transactions may persist in a sophisticated market over a substantial period, with attendant social losses as a result. Hence it is not necessarily puzzling that routinely used certification practices fail to yield substantial informational value or a gold-plated array of third-party intermediaries fails to screen out recurrent patterns of fraudulent behavior.

I develop this “degenerate” certification thesis through a detailed examination of the third-party legal opinion (or in short, “closing opinion”), which is commonly issued by law firms at the consummation of certain significant business transactions such as acquisitions and

---

<sup>5</sup> For discussions of the implications of Enron and other recent scandals for confidence in the “gatekeeping” capacities of certifiers and other intermediaries, see JOHN C. COFFEE, JR., GATEKEEPERS 2-3 (2005); John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301 (2004) [hereinafter Coffee, *Gatekeeper Failure*]; John C. Coffee, Jr., *Understanding Enron: “It’s About the Gatekeepers, Stupid”*, 57 BUS. LAW. 1403 (2002) [hereinafter Coffee, *Understanding Enron*]; Frank Partnoy, *Barbarians at the Gatekeepers? A Proposal for a Modified Strict Liability Regime*, 79 WASH. U. L. Q. 491 (2001) [hereinafter Partnoy, *Barbarians*].

financings. For the analytical purpose of identifying practical limits to the standard certification thesis, this narrow (but to practitioners, familiar) corner of business-law practice provides an unusually “clean” setting that substantially lacks several distorting characteristics that would otherwise be obvious sources of market failure: (1) both providers and recipients of the certification instrument are sophisticated, thereby probably barring any undersupply or oversupply inefficiencies characteristic of a “credence good” market<sup>6</sup>, (2) depending on market definition, there are at least tens and probably hundreds of actual and potential certification providers, thereby sharply reducing the reasonable likelihood of any collusion-related inefficiencies, and (3) there are few legal requirements or other regulatory interventions that would otherwise skew the market’s “natural selection” of the most efficient certification practice.<sup>7</sup>

Following the standard certification thesis, most of the limited academic literature<sup>8</sup> and some, but not all, of the voluminous practitioner literature<sup>9</sup> teaches that a closing opinion

---

<sup>6</sup> A “credence good” market is a market where (i) sellers are more sophisticated than buyers and (ii) the quality of the relevant good cannot be ascertained pre-purchase and can only be imperfectly ascertained post-purchase. Classic examples are car repair and medical services (and legal services where clients are unsophisticated).

<sup>7</sup> These potentially distorting factors are however not entirely absent in the closing-opinion setting. For further discussion, see *infra* Part IV.D.

<sup>8</sup> For the only other dedicated scholarly treatment of closing opinions, see Jonathan C. Lipson, *Price, Path and Pride: Third-Party Closing Opinion Practice Among U.S. Lawyers (A Preliminary Investigation)*, 3 BERKELEY BUS. L. J. 59 (2005). For additional relevant discussion, see Steven L. Schwarcz, *To Make or To Buy: In-House Lawyering and Value Creation* (Duke Law School Working Paper, Oct. 2006), avail. at [www.bepress.com](http://www.bepress.com) [hereinafter Schwarcz, *To Make or To Buy*]; Karl S. Okamoto, *Reputation and the Value of Lawyers*, 74 OR. L. REV. 15 (1995); Ronald Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L. J. 239 (1984) [hereinafter Gilson, *Value Creation*]. Two previous law review symposia dedicated in part to legal opinions contain helpful contributions: a Spring 1995 edition of the Oregon Law Review and a 1989 edition of the Columbia Business Law Review. Additionally, a few publications have recently appeared relating specifically to legal opinions in structured-finance transactions. See Steven L. Schwarcz, *The Limits of Lawyering: Legal Opinions in Structured Finance*, 84 TEXAS L. REV. 1 (2005) [hereinafter Schwarcz, *Limits of Lawyering*]; Jonathan Macey, *The Limits of Legal Analysis: Using Externalities to Explain Legal Opinions in Structured Finance*, 84 TEX. L. REV. 75, 76 (2005); John C. Coffee, Jr., *Comment: Can Lawyers Wear Blinders? Gatekeepers and Third-Party Opinions*, 84 TEX. L. REV. 59 (2005) [hereinafter Coffee, *Comment*]; Steven L. Schwarcz, *We Are All Saying Much The Same Thing: A Rejoinder to the Comments of Professors Coffee, Macey and Simon*, 84 TEX. L. REV. 93 (2005) [hereinafter Schwarcz, *Same Thing*].

provides meaningful assurance from a trustworthy intermediary as to various fundamental matters that I group under the rubric of “contracting quality”, which includes most notably the enforceability of the contractual obligations being undertaken by the firm’s client.<sup>10</sup> Contrary to this position, however, some legal practitioners (including the Business Law Section of the

---

<sup>9</sup> The leading legal opinion treatise is: DONALD W. GLAZER ET AL., *GLAZER & FITZGIBBON ON LEGAL OPINIONS: DRAFTING, INTERPRETING AND SUPPORTING CLOSING OPINIONS IN BUSINESS TRANSACTIONS* (2d ed. 2001 & Cum. Supp. 2006). The national, regional and specialized bar associations have produced a plethora of reports on various types of legal opinions. The “TriBar Opinion Committee”, initially consisting of members drawn from New York bar associations and now including representatives from bar associations in other major metropolitan areas, has produced various reports, including: TRIBAR OPINION COMMITTEE, *Special Report of the TriBar Opinion Committee: The Remedies Opinion—Deciding When to Include Exceptions and Assumptions*, 59 BUS. LAW. 1483 (2004) [hereinafter, *2004 TriBar Special Report*], reprinted in GLAZER ET AL., *supra* note \_\_, at App. 4A; TRIBAR OPINION COMMITTEE, *Third-Party “Closing” Opinions: A Report of the TriBar Opinion Committee*, 53 BUS. LAW. 591 (1998) [hereinafter, 1998 TRIBAR REPORT], reprinted in GLAZER ET AL., *supra* note \_\_, at App. 4A; TRIBAR OPINION COMMITTEE, *Special Report of the TriBar Opinion Committee: The Remedies Opinion*, 46 BUS. LAW. 959 (1991) [hereinafter, *TriBar Remedies Opinion*]; TRIBAR OPINION COMMITTEE, *Second Addendum to Legal Opinions to Third Parties: An Easier Path*, 44 BUS. LAW. 563 (1989); TRIBAR OPINION COMMITTEE, *An Addendum – Legal Opinions to Third Parties: An Easier Path*, 36 BUS. LAW. 429 (1981); TRIBAR OPINION COMMITTEE, *Third-Party “Closing” Opinions: A Report of the TriBar Opinion Committee*, 34 BUS. LAW. 1891 (1979). The American Bar Association has also issued several releases pertaining to legal opinions. *See* AMERICAN BAR ASSOCIATION SECTION OF BUSINESS LAW, COMMITTEE ON LEGAL OPINIONS AND THE TRIBAR OPINION COMMITTEE, *THE COLLECTED ABA AND TRIBAR OPINION REPORTS* (2005) (which usefully includes all of the recent ABA and TriBar Committee reports on legal opinions); AMERICAN BAR ASSOCIATION, SECTION OF BUSINESS LAW, COMMITTEE ON LEGAL OPINIONS, *Third-Party Legal Opinion Report, Including the Legal Opinion Accord*, 47 BUS. LAW. 167 (1991), reprinted in PRACTICING LAW INSTITUTE, *LEGAL OPINIONS: THE IMPACT OF THE TRIBAR COMMITTEE’S NEW REPORT ON LEGAL OPINION PRACTICE* 177-186 (1998) [hereinafter, *ABA Legal Opinion Accord*]; AMERICAN BAR ASSOCIATION, SECTION OF BUSINESS LAW, COMMITTEE ON LEGAL OPINIONS, *Legal Opinion Principles*, reprinted in GLAZER ET AL., *supra* note \_\_, at App. 3 [hereinafter, *ABA Legal Opinion Principles*]; AMERICAN BAR ASSOCIATION, SECTION OF BUSINESS LAW, COMMITTEE ON LEGAL OPINIONS, *Report: Guidelines for the Preparation of Closing Opinions*, 57 BUS. LAW. 875 (2002) [hereinafter, *ABA Guidelines*]. Also of note are reports issued by the California, Texas and Michigan bars: OPINIONS CMTE. OF THE CALIFORNIA STATE BAR BUSINESS LAW SECTION, *Toward a National Legal Opinion Practice: The California Remedies Opinion Report*, 60 BUS. LAW. 907 (2005) [hereinafter *California Remedies Opinion Report*]; THE CORPORATIONS COMMITTEE OF THE BUSINESS LAW SECTION OF THE STATE BAR OF CALIFORNIA, *Legal Opinions in Business Transactions (Excluding the Remedies Opinion) (Exposure Draft)* (Jan. 28, 2005), avail. at [www.calbar.ca.gov](http://www.calbar.ca.gov) [hereinafter, 2005 CALIFORNIA BAR REPORT]; THE STATE BAR OF CALIFORNIA BUSINESS LAW SECTION, *REPORT ON THIRD-PARTY REMEDIES OPINIONS* (Sept. 2004), reprinted in GLAZER ET AL., *supra* note \_\_, at App 9A [hereinafter, 2004 CALIFORNIA BAR REPORT], also avail. at [www.calbar.ca.gov](http://www.calbar.ca.gov); STATE BAR OF TEXAS, BUSINESS LAW SECTION, *REPORT OF THE LEGAL OPINIONS COMMITTEE REGARDING LEGAL OPINIONS IN BUSINESS TRANSACTIONS* (1991), reprinted in GLAZER ET AL., *supra* note \_\_, at App. 21 [hereinafter, TEXAS BAR REPORT]; and REPORT OF THE AD HOC CMTE. OF THE BUSINESS LAW SECTION OF THE STATE BAR OF MICHIGAN ON STANDARDIZED LEGAL OPINIONS IN BUSINESS TRANSACTIONS, reprinted in GLAZER ET AL., *supra* note \_\_, at App. 17 [hereinafter, MICHIGAN BAR REPORT]. This is by no means a complete list of all relevant bar association reports and trade publications.

<sup>10</sup> *See infra* Part II.A.

California Bar<sup>11</sup>) and other industry participants express concern that at least some closing opinions may be a costly distraction leading to no appreciable value-enhancing result. A close examination of closing opinion practice provides strong support for this alternative view, revealing multiple factors that substantially impede any meaningful assurance function, including most notably: the highly qualified language used in closing opinions, an opining firm's inherent conflict of interest and minimal legal and reputational liability exposure (as shown in part through a detailed survey of relevant case-law over the past 20 years), and the availability of more robust diligence alternatives. Taken together, these factors cast serious doubt whether a closing opinion typically contributes significant incremental information to opinion recipients and therefore has any appreciable capacity to mitigate informational asymmetries that would otherwise generate pricing or structural distortions.

Assuming that the incremental informational value typically conveyed by a closing opinion at least sometimes does not exceed the costs of preparing and negotiating it, why would this instrument persist as a routine transactional practice in sophisticated market settings? As a solution to this emergent "opinion puzzle" (and, by extension, other entrenched certification practices upon which market participants and observers routinely cast doubt), I propose a two-sided incentive structure that operates as follows: (i) demand is sustained by an agency-cost mechanism as a result of which a "requesting agent" requests a non-cost-justified but entrenched certification instrument in order to mitigate the reputational penalty for perceived professional incompetence, and (ii) supply is sustained by an adverse-selection mechanism as a result of which "requested parties" provide the requested certification in order to avoid being placed on the extreme-low end of a contracting quality spectrum. So long as demand is sustained as a

---

<sup>11</sup> See 2004 CALIFORNIA BAR REPORT, *supra* note \_\_, in GLAZER ET AL., at App. 9A:9-10; 2005 CALIFORNIA BAR REPORT, *supra* note \_\_, at 4, 14-15. For further discussion, see *infra* notes [33-38] and accompanying text.



result of the misalignment of incentives between the requesting principal and its agent, supply usually follows: given that the requested certification is easily obtainable and customarily issued, failure to provide it triggers the negative implication that there exists a highly problematic fact that has not been previously disclosed, thereby resulting in a substantial quality discount up to and including termination of the proposed transaction.

This incentive structure shows how a competitive market may rationally overinvest in minimally informative certification instruments that generate nontrivial transaction costs without at least commensurate benefits in the form of incremental informational value. While developed within the closing-opinion context, this structure is formulated generically and, as I show preliminarily with respect to credit ratings in the debt offering markets, fairness opinions in the corporate acquisitions market and certain forms of contractual boilerplate in corporate-law practice, offers a diagnostic tool for identifying and accounting for other certification practices that are both widely used in sophisticated settings and frequently questioned by the practitioner, policymaking and scholarly communities. But this is not to say that “certification drag” is necessarily incurable. The relevant market may ultimately remedy this state of affairs through the pioneering actions of certain “lead” participants who are sufficiently confident in being able to accrue substantial reputational gains by deviating from inefficient industry convention. This self-curative outcome finds support in several modest contractions in the use of closing opinions and more radical contractions in the use of certain other legal opinions. However, any self-curative outcome may be substantially delayed where regulatory distortions, trade associations, entry barriers or other market imperfections unduly increase the anticipated costs of deviating from entrenched industry protocol.

This Article is organized as follows. In Part I, I describe the standard certification thesis and review relevant portions of the associated theoretical and empirical literature. In Part II, I examine the typical procedural and cost burdens in connection with issuing a closing opinion and describe multiple factors that may dilute its informational value, which together identify the emergent opinion puzzle. In Part III, I present the aforementioned incentive structure as a possible solution to the opinion puzzle. In Part IV, I assess the capacity of the legal market (and by implication, other certification markets) independently to correct a degenerate certification practice. In Part V, I explore applications of the proposed incentive structure to other widely used *and* widely questioned certification practices in sophisticated business transactions.

I. *Certification Revisited.* In this Part, I describe the standard certification thesis, as it typically has been presented and applied in the law-and-economics (and *some* of the associated economics) literature, and then review empirical efforts to assess the informational benefits conferred by commonly employed certification practices in the financial markets. As described below, while the certification thesis cogently explains how third-party intermediaries can improve market efficiency by relieving informational asymmetries between contracting parties, empirical attempts to validate this thesis in core transactional settings often reach surprisingly mixed results.

A. *Theory.* It is well known that informational asymmetries can prevent, or at least distort the pricing or other terms, of efficient transactions where sellers find it too costly to credibly convey private information to potential buyers. It is also well known that sellers sometimes overcome these informational asymmetries by recourse to trustworthy third parties

who issue certification instruments that credibly signal the quality of the relevant asset, thereby allowing buyers to distinguish between higher-quality and lower-quality sellers.<sup>12</sup> Crucially, the signaling capacity of any certification instrument depends on the extent to which the higher-quality seller thereby incurs a cost that a lower-quality seller cannot bear (because it will not be able to recoup the cost of the signal once its low quality is revealed), which in turn permits buyers to distinguish between higher and lower-quality sellers, thereby enabling the former to earn an appropriate quality premium. Certification proxies (or more generally, signaling instruments) that meet this condition generate efficiency benefits (net of resources expended on the certification process) by mitigating informational asymmetries that may otherwise frustrate or distort mutually beneficial exchanges.

This is a cogent thesis and law-and-economics scholars have widely cited it as an efficiency explanation for the role of attorneys, auditors, underwriters, investment bankers and other costly intermediaries that commonly accompany the diligence, negotiation and execution of sophisticated business transactions.<sup>13</sup> These discussions, however, rarely make reference to a complex and well-developed body of economic models that identifies multiple conditions for *inefficient* outcomes in signaling markets generally and certification markets in particular.<sup>14</sup> A somewhat skewed intellectual genealogy seems to exist: while the law-and-economics literature

---

<sup>12</sup> For the leading source, see Michael Spence, *Job Market Signaling*, 87 Q. J. ECON. 355 (1973).

<sup>13</sup> See COFFEE, *supra* note \_\_, at 2-3 (describing general assumption that financial market gatekeepers act as reputational intermediaries); Partnoy, *Barbarians*, *supra* note \_\_, at 546 (same). For specific examples, see Gilson, *Value Creation*, *supra* note \_\_, at 290-91 (arguing that lawyers act as “reputational intermediaries” and that an effective reputational intermediary will emit a credible quality signal because it has rational incentives to maintain a trustworthy reputation in order to attract further business); Victor P. Goldberg, *Accountable Accountants: Is Third-Party Liability Necessary?*, 17 J. LEGAL STUD. 295, 312 (1988) (arguing that auditors have adequate market-based incentives to act diligently insofar as failure to do so results in a reputational penalty).

<sup>14</sup> This economic literature is extensive. For overviews, see John G. Riley, *Silver Signals: Twenty-Five Years of Screening and Signaling*, 39 J. ECON. LIT. 432 (2001); Joseph E. Stiglitz, *Information and the Change in the Paradigm in Economics*, 92 AMER. ECON. REV. 460 (2002). For references to some of the limited economic literature on certification inefficiencies in particular, see *infra* note [17], and for specific applications of excessive signaling models, see *infra* note [125].

widely cites Noble Prize winner Michael Spence for the proposition that signaling opportunities can generate efficiency *gains* by enabling uninformed parties to distinguish between higher and lower-quality counterparties, it seems to hardly ever cite Spence's other (and, in his work, arguably more central) proposition that signaling opportunities can generate efficiency *losses* by inducing dissipative investments that redistribute existing resources at a positive transaction cost without generating commensurate productivity or other social gains<sup>15</sup>.<sup>16</sup> To be sure, the law-and-economics literature generally acknowledges some inherent limits to the bonding capacity of reputational intermediaries, thereby giving rise to a second-order "lemons" problem that must be mitigated by imposing legal liability or other measures.<sup>17</sup> And in the post-Enron period, several scholars have identified other conditions where the reputational constraints of third-party

---

<sup>15</sup> This thesis (which Spence develops in the education context) requires that signaling investments do not enlarge the total social product by generating "matching efficiencies" or "human capital" effects that increase productivity. While this assumption may be somewhat unrealistic in its unqualified form, some portion of a signaling investment will always be purely redistributive (and therefore, socially excessive) to the extent that the private return from any such investment exceeds the social return. See A. MICHAEL SPENCE, *MARKET SIGNALING: INFORMATIONAL TRANSFER IN HIRING AND RELATED SCREENING PROCESSES* (1974); Michael Spence, *Job Market Signaling*, 87 Q. J. ECON. 355 (1973); Michael Spence, *Competition in Salaries, Credentials and Signaling Prerequisites for Jobs*, 90 Q. J. ECON. 51 (1976).

<sup>16</sup> As a somewhat crude proxy, a preliminary survey of the Westlaw "Journals & Law Review" database generates 167 references to "Spence" and "signal" in the same sentence, of which only 2 appear to refer to Spence's inefficiency result. A notable exception to the statement above is the recent well-noted article by Philippe Aghion & Benjamin Hermalin, *Legal Restrictions on Private Contracts Can Enhance Efficiency*, 6 J. L. ECON. & ORG. 381 (1990).

<sup>17</sup> See Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J. L. ECON. & ORG. 53 (1986) (stating that investors trust the monitoring services provided by underwriters, accounting firms, and law firms because these intermediaries are believed to be repeat players subject to reputational pressures to detect and prevent issuer carelessness or deceit, but otherwise noting that reputational pressures are inherently limited, therefore sometimes requiring the imposition of legal liability). For more extended analyses that specifically emphasizes the inherent limitations of certification intermediaries, see Stephen Choi & Jill E. Fisch, *How to Fix Wall Street: A Voucher Financing Proposal*, 113 Yale L. J. 269 (2003) (arguing that inherent free-riding on information provided to the market by securities intermediaries necessitates funding mechanisms that in turn create conflicts of interests, thereby impeding the quality of the information provided); Stephen Choi, *Market Lessons for Gatekeepers*, 92 NW. U. L. REV. 916 (1998) (showing that certification intermediaries can fail depending on the size of the certification fee, the level of screening accuracy and the anticipated proportion of low-quality and high-quality firms in the relevant market, but arguing that this does not recommend the straightforward imposition of mandatory legal liability). More formal analyses of "reputational failure" are found in the small economic literature that specifically models certification behavior. See, e.g., Luigi Alberto Franzoni, *Imperfect competition in certification markets*, in Bernardo Bortolotti & Gianluca Fiorentini (eds.), *ORGANIZED INTERESTS AND SELF-REGULATION: AN ECONOMIC APPROACH* (1999); Gian Luigi Albano & Alessandro Lizzeri, *Strategic Certification and Provision of Quality*, 42 INT'L ECON. REV. 267 (2001).

intermediaries may fail to generate the efficient outcome anticipated by the standard certification thesis<sup>18</sup>, including conflicts of interest, limited screening capacities, differential sophistication, and entry barriers in the certification market.<sup>19</sup> Nonetheless, it is fair to say that the law-and-economics literature generally counsels confidence in the net social value of certification intermediaries, who are typically presumed to alleviate informational obstacles that may distort or impede efficient market transactions. Some courts have even put this optimistic view to practice; most notably, the Seventh Circuit denied an aiding-and-abetting claim against a then-leading accounting firm on the ground, in part, that the prestigious defendant would not rationally endanger its vast reputational capital on the profits to be gained in facilitating a single client's fraudulent action.<sup>20</sup> In the wake of Arthur Andersen's fall from grace and Enron's subsequent implosion, this unqualified confidence in the socially efficient behavior of even well-established intermediaries appears to have some serious practical limitations.

B. *Evidence.* Even if the certification thesis is entirely cogent as a theoretical matter, empirical attempts to validate it in real-world settings surprisingly often reach mixed and occasionally even contrary results. While the certification thesis finds some (mostly qualitative)

---

<sup>18</sup> See, e.g., Frank Partnoy, *Strict Liability for Gatekeepers: A Reply to Professor Coffee*, 84 B.U. L. REV. 365, 375 (2004) [hereinafter Partnoy, *Strict Liability*] (arguing that prior literature on gatekeepers rested on untenable assumptions as to the effectiveness of reputational constraints on gatekeeper misconduct)

<sup>19</sup> For the most complete inventory of potential defects in the gatekeeping capacity of market intermediaries, see JOHN C. COFFEE, JR., *GATEKEEPERS* (2005). For additional relevant discussions, see John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301 (2004) [hereinafter Coffee, *Gatekeeper Failure*]; John C. Coffee, Jr., *Understanding Enron: "It's About the Gatekeepers, Stupid"*, 57 BUS. LAW. 1403 (2002); Frank Partnoy, *Strict Liability for Gatekeepers: A Reply to Professor Coffee*, 84 B.U. L. REV. 365 (2004); Frank Partnoy, *Barbarians at the Gatekeepers? A Proposal for a Modified Strict Liability Regime*, 79 WASH. U. L. Q. 491 (2001).

<sup>20</sup> See *DiLeo v. Ernst & Young*, 901 F.2d 624, 629 (7<sup>th</sup> Cir. 1990). This logic has apparently been followed in other court decisions concerning accountants' liability. See Robert A. Prentice, *The Case of the Irrational Auditor: A Behavioral Insight into Securities Fraud Litigation*, 95 NW. U. L. REV. 133, 135-39 (2000).

support in certain (mostly historical) market settings<sup>21</sup>, reviews of the relevant empirical literature agree that generally the data is not abundant and often mixed.<sup>22</sup> In particular, ambiguous findings have been reached with respect to the marginal informational value of several certification practices routinely used in high-stakes financial transactions: audit reports and other financial statements released by publicly traded corporations to the equity markets<sup>23</sup>, bond ratings issued by credit-rating agencies to the debt markets<sup>24</sup> and some “fairness opinions”

---

<sup>21</sup> For a collection of such studies, see DANIEL B. KLEIN (ed.), *REPUTATION: STUDIES IN THE VOLUNTARY ELICITATION OF GOOD CONDUCT 195-96* (1997) [hereinafter *REPUTATION*]. For a review of more quantitative studies, see Ginger Zhe Jin et al., *That's News to Me! Information Revelation in Professional Certification Markets*, Nat'l Bureau of Econ. Res., Working Paper #12390 (July 2006).

<sup>22</sup> See Stefano Gatti, Stefanie Kleimeier, William L. Megginson & Alessandro Steffanoni, *Arranger Certification in Project Finance* (working paper Mar. 2007), avail. at [www.ssrn.com](http://www.ssrn.com) (noting that “empirical research has found little unambiguous evidence of third-party certification in capital markets financings”); Jin et al., *supra* note \_\_ (noting that little is known empirically about when certification products add informational value to relevant transactions); Riley, *supra* note \_\_, at 455 (noting that there is little empirical research to confirm the multiple signaling theories with respect to advertising, warranties and pricing strategies and that the existing research draws mixed conclusions).

<sup>23</sup> See Clive Lennox, *The Accuracy and Incremental Informational Content of Audit Reports in Predicting Bankruptcy*, 26 J. Bus. Fin. & Acctg. 757 (1999) (based on sample of 976 UK public companies during 1987-1994, finding that audit reports were not accurate signals of impending bankruptcy or the probability of its occurrence); Maria Benau et al., *Reactions of the Spanish Capital Market to Qualified Audit Reports*, 13 EURO. ACCOUNTING REV. 689 (2004) (reviewing stock-price reaction of Spanish public stocks to issuance of a qualified audit and finding that qualified audit reports have no incremental information value for investors); John A. Elliott, “Subject to” *Audit Opinions and Abnormal Security Returns—Outcomes and Ambiguities*, 20 J. ACCTG. RES. 617 (1982) (finding that informational content of audit opinions qualified by a material contingency is unresolved and noting evidence that suggests the informational value is small relative to information already available to the market). More generally, see Jin et al., *supra* note \_\_ (noting that empirical literature shows that only some audit reports yield informational value to the market), and for a more popular account of the questionable informational value of audit reports, see MICHAEL POWER, *THE AUDIT EXPLOSION* 13 (1999).

<sup>24</sup> See Frank Partnoy, *The Paradox of Credit Ratings*, in *RATINGS, RATING AGENCIES AND THE GLOBAL FINANCIAL SYSTEM* 65-84 (Richard M. Levich et al. eds. 2002) (arguing that there is little empirical data showing that credit ratings contribute new information to the market and that credit rating changes often lag, and are anticipated by, the market); Mariano, *supra* note \_\_ (noting that credit rating agencies have only downgraded ratings following or shortly preceding multiple adverse events, thereby simply reflecting information that had already been priced into the relevant market, and describing empirical literature’s failure to conclusively determine whether rating changes affect market pricing of bond issues); Jin et al., *supra* note \_\_, at 6-7 (noting that the empirical literature on the informational value of bond ratings is inconclusive); Robert C. Merton & Zvie Bodie, *On the Management of Financial Guaranties*, 21 FIN. MGMT. 87 (1992) (arguing that credit rating agencies may have rational incentives to ignore contrary private information where market consensus recommends downgrade, given large reputational injury in the event a positive rating, contrary to market consensus, proves to be erroneous). For a similar phenomenon in credit ratings of insurance companies, see Ajai K. Singh & Mark L. Power, *The Effects of Best’s Rating Changes on Insurance Company Stock Prices*, 59 J. RISK & INSURANCE 310 (1992) (finding that rating changes of leading third-party ratings provider in insurance industry generate little stock price reaction).

issued by investment-bank advisors in merger and acquisition transactions.<sup>25</sup> While finance economists have devoted considerable attention to assessing the certification benefits of prestigious intermediaries in initial public offerings, these efforts have not always yielded compelling results<sup>26</sup>: reasonably persuasive support exists for the certification benefits conferred by prestigious underwriters (although these findings too are periodically qualified or reversed)<sup>27</sup> but support for the certification benefits routinely attributed to prestigious auditors<sup>28</sup> and venture capitalists<sup>29</sup> remains almost consistently mixed.

---

<sup>25</sup> See Darren J. Kisgen, Jun Qian & Weihong Song, *Are Fairness Opinions Fair? The Case of Mergers and Acquisitions* (Jan. 2007), available on [www.ssrn.com](http://www.ssrn.com) (finding that deal premiums are reduced when acquirers obtain fairness opinions, long-term stock performance improves when an acquirer obtains a second fairness opinion, and target fairness opinions appear to have no effect on the quality of the transaction); Lucy Huajing Chen, *Merger Abnormal Returns and the Use of Independent Fairness Opinions* (Nov. 2006), avail. at [www.ssrn.com](http://www.ssrn.com) (showing that, for an 18-month period following consummation of the relevant merger, acquirors that obtain fairness opinions from independent advisers outperform (during the 3-day window around merger preannouncements) acquirors that obtain a nonindependent fairness opinion, but finding no such relationship with respect to target firms). For a qualitative analysis expressing doubt as to the informational value of fairness opinions, see Lucien Bebchuk & Marcel Kahan, *Fairness Opinions: How Fair Are They and What Can Be Done About It?*, 1989 DUKE L.J. 27.

<sup>26</sup> See Gatti et al., *supra* note \_\_ (stating that “there is very little empirical support for issuer certification in the finance literature”). This same source supplies an exception to the “rule” state above, finding support for certification benefits in project-finance transactions as a function of arranger prestige, which apparently facilitates arrangement of larger and more highly leveraged loans.

<sup>27</sup> See, e.g., Richard B. Carter et al., *Underwriter Reputation, Initial Returns and the Long-Run Performance of IPO Stocks*, 53 J. Fin. 285 (1998) (noting findings in prior literature establishing that underwriter reputation limits short-term underpricing and further showing that underwriter reputation correlates with reduced underperformance during 3-year period following IPO); Randolph P. Beatty & Ivo Welch, *Issuer Expenses and Legal Liability in Initial Public Offerings*, 39 J. L. & ECON. 545, 576-85 (1996) (showing that IPO underpricing falls when issuers hire elite underwriters and attributing this result to the fact that elite underwriters provide investors with improved quality assurance); Kenneth N. Daniels & Jayaraman Vijayakumar, *Does Underwriter Reputation Matter in the Municipal Bond Market?*, J. ECON. & BUS. (2006) (using large sample of tax-exempt municipal bonds, showing that bond issues managed by more prestigious underwriters have lower borrowing costs and lower underwriting spreads, suggesting that underwriters do confer meaningful certification benefits). Some recent studies are more equivocal. See, e.g., Hoje Jo et al., *Underwriter Choice and Earnings Management: Evidence from Seasoned Equity Offerings*, Rev. Acctg. Stud. (2006) (arguing that negative correlation between underwriter prestige and earnings management by relevant client suggests that prestigious underwriters provide quality certification, which is further supported by positive correlation between underwriter prestige and post-issue performance in the “seasoned equity” market, although this latter relationship does not last long); Steven D. Dolvin, *Market Structure, Changing Incentives and Underwriter Certification*, 28 J. FIN. RES. 3 (2004) (noting divergence in empirical literature on certification value of underwriter reputation, with results finding positive and negative correlations between underwriter reputation and underpricing, but arguing that negative correlation is consistent with certification thesis insofar as effects associated with larger market share are responsible for “reversed” correlation).

<sup>28</sup> The literature is not uniform. For affirmative results, see Stephanie Rauterkus & Kyojik Song, *Auditor’s Reputation, Equity Offerings and Firm Size: The Case of Arthur Andersen*, 34 FIN. MGMT. 4 (2005) (finding differential pricing of IPOs based on comparison of Arthur Andersen clients and other firms during period

As I describe in greater detail subsequently<sup>30</sup>, these middling findings in the scholarly literature are matched by skepticism expressed by some industry participants, judges, regulators and/or policy commentators as to the informational value of some of these widely distributed certification practices. Legal practitioners' and bar associations' discussions of closing opinion

---

surrounding criminal indictment of Arthur Andersen, suggesting that auditors provide certification benefits to clients); Sattar A. Mansi et al., *Does Auditor Quality and Tenure Matter to Investors? Evidence from the Bond Market?*, 42 J. Acctg. Res. 755 (2004) (finding that auditor quality and tenure are negatively related to the cost of financing, suggesting that auditor reputation and longevity confers certification benefits on the relevant issuer). For mixed to affirmative results, see Ronald J. Balvers et al., *Underpricing of New Issues and the Choice of Auditor as a Signal of Investment*, 4 ACCTG. REV. 605 (1988) (noting difficulty in prior studies in establishing the expected negative correlation between auditor reputation and underpricing of new issues, but showing this correlation is robust when issuers retain both prestigious investment banker and auditor); Krishnagopal Menon & David Deviate. Williams, *Auditor Credibility and Initial Public Offerings*, 66 ACCTG. REV. 313 (1991) (finding that few IPO firms switch from local to more prestigious auditor prior to offering but that firms that do switch tend to be represented by a prestigious investment banker and pay a lower investment banking fee, suggesting that retention of a prestigious auditor provides the IPO firm with certification benefits). For mixed to contrary results, see Mason Gerety & Kenneth Lehn, *The Causes and Consequences of Accounting Fraud*, 18 MANAG. & DEC. ECON. 587 (1997) (finding that frequency of accounting fraud does not vary significantly among firms audited by "Big Eight" auditors relative to firms audited by other auditors, suggesting that firm reputation plays little role in deterring management from engaging in fraudulent activity); Xin Chang et al., *The Effect of Audit Quality on Initial Public Offerings in Australia* (Sept. 2005), avail. on [www.ssrn.com](http://www.ssrn.com) (finding that, while there is a fee premium for elite auditors in the Australian IPO market, there is a positive correlation between audit quality and underpricing, which suggests that a prestigious auditor is not providing certification benefits, and no correlation between audit quality and long-term performance, which suggests that any certification benefits are unjustified).

<sup>29</sup> The literature is not uniform, with more recent findings generally reaching ambiguous results. For a review of the literature, see Elke Klaasen & Henk von Eije, *Earnings Growth and Underpricing with Venture Capital Backed Initial Public Offerings* (Working Paper 2006), avail. at [www.ssrn.com](http://www.ssrn.com). For specific examples, see *id.* (using sample of 55 initial public offerings in the Netherlands and finding ambiguous certification benefit as a result of venture-capital backing, with venture-capital backing increasing underpricing in IPOs that showed large net earnings growth and decreasing it in IPOs that showed small net earnings growth, and tentatively attributing these results to differential sophistication between informed and less informed investors); Alon Brav & Paul Gompers, *Underperformance of Initial Public Offerings: Evidence from Venture and Nonventure Capital-Backed Companies*, 52 J. Fin. 1791 (1997) (finding that, in sample of approximately 900 firms during 1972-1992, venture-capital-backed IPO firms outperform non-venture-capital backed IPO firms, but only when returns are weighted equally); Thomas J. Chemmanur, *The Role of Venture Capital Backing in Initial Public Offerings: Certification, Screening or Market Power?* (Mar. 2006), avail. on [www.ssrn.com](http://www.ssrn.com) (finding little support that venture capitalists confer certification benefits on IPO firms, some support that venture capitalists perform a screening and monitoring function with respect to IPO firms and strong support that venture capitalists improve IPO performance by ability to attract higher-quality investment bankers, underwriters, analysts and other intermediaries); GEORG RINDERMANN, VENTURE CAPITALIST PARTICIPATION AND THE PERFORMANCE OF IPO FIRMS: EMPIRICAL EVIDENCE FROM FRANCE, GERMANY AND THE UK (2004) (finding that venture-backed IPOs do not generally perform better than non-venture-backed IPOs, aside from subgroup of internationally operating venture capitalists); Stefanie Franzke, *Underpricing of Venture-Backed and Non Venture-Backed IPOs: Germany's Neuer Markt*, in G. GUIDICI & P. ROSENBOOM, THE RISE AND FALL OF EUROPE'S NEW STOCK MARKETS, Ch. 9 (2004) (finding positive correlation between underpricing and venture-backed or non-venture-backed IPOs, suggesting that venture capitalists do not provide any certification benefits to IPO firms).

<sup>30</sup> See *infra* Part V.



practice sometimes voice similar doubts. In a straightforward application of the certification thesis, the standard efficiency rationale for closing opinions holds that the opining firm certifies as to the matters addressed in the opinion on the assumption that the firm's reputational and legal exposure would not lead it to do so recklessly or dishonestly.<sup>31</sup> This in turn implies that transacting parties rationally expend resources on a closing opinion only so long as the anticipated informational value yielded as a result exceeds anticipated resource expenditures. Nonetheless some lawyers and other industry participants, as reported in trade publications and practitioner surveys<sup>32</sup>, and some bar association reports, question whether these research, drafting and negotiation efforts always or even usually pass this cost-benefit test.<sup>33</sup> These doubts "on the ground" raise concerns as to whether closing opinion practice actually generates the efficiency gains anticipated by the certification thesis. Based in part on a 2004 survey of California practitioners, the Business Law Section of the California Bar has expressed the view that some (but, it emphasizes, not all) closing opinions may increase transaction costs without

---

<sup>31</sup> See Gilson, *Value Creation*, 290-92, *supra* note \_\_; Michael Gruson et al., LEGAL OPINIONS IN INTERNATIONAL TRANSACTIONS (1989, 2d ed.), at 4; Deer, *supra* note \_\_, at I-2; Dillon, *supra* note \_\_, at 3; Okamoto, *supra* note \_\_, at 27.

<sup>32</sup> For existing surveys of practitioners with respect to closing opinions (among other topics): see Lipson, *supra* note \_\_; 2004 CALIFORNIA BAR REPORT, in GLAZER ET AL., *supra* note \_\_, at App. 9A:80-88; and Schwarcz, *To Make or To Buy*, *supra* note \_\_.

<sup>33</sup> See, e.g., 2004 CALIFORNIA BAR REPORT, *supra* note \_\_, in GLAZER ET AL., *supra* note \_\_ at App. 9A:6; James Fuld and Arthur Field, *Toward Eliminating Differing Interpretations of Opinions Relating to Agreements*, May 24, 1988, reprinted in AMERICAN BAR ASSOCIATION, NATIONAL INSTITUTE, THE SILVERADO SUMMIT: THE STANDARDIZATION OF LEGAL OPINIONS – ORDER OUT OF CHAOS (1989); Dillon, *supra* note \_\_; Lipson, *supra* note \_\_, at \_\_. See also TEXAS BAR REPORT, in GLAZER ET AL., *supra* note \_\_, at App. 21:78 (stating that costs of rendering a legal opinion even in a simple transaction are significant and may not always be cost-effective); Mason & Snider, *Those Third-Party Closing Opinions: Can Loan Transaction Costs Be Reduced?*, 7 BUS. L. TODAY 48 (Sept./Oct. 1997) (expressing doubt with respect to whether UCC and enforceability opinions that lenders typically request from borrower's counsel are cost-justified); 2004 CALIFORNIA BAR REPORT, in GLAZER ET AL., *supra* note \_\_, at App 9A:21 (noting a long-standing frustration among lawyers and clients with the burdens imposed on transactions by the preparation and negotiation of enforceability opinions); Thomas L. Ambro & J. Truman Bidwell, Jr., *Some Thoughts on the Economics of Legal Opinions*, 1989 COLUM. BUS. L. REV. 307 (1989) (noting that several types of highly qualified opinions have doubtful meaningful value or, absent such qualifications, require investigation by the opining firm that is not cost-effective); *California Remedies Opinion Report*, *supra* note \_\_, at 910 (arguing that opinion process can generate lengthy discussion while rarely raising any enforceability issues unknown to the opinion recipient or its counsel).

“any real benefit”<sup>34</sup> and that certain opinions that were previously considered customary should “now be considered inappropriate . . . because their scope is not reasonably within the competence of the opinion giver or they are not cost-justified”.<sup>35</sup> To a lesser extent, other bar associations have noted periodically that the opinion process often imposes costs on the opinion-giver in excess of any benefit to the opinion recipient.<sup>36</sup> Reflecting this state of uncertainty, the California Bar committee further notes that “[f]rustration over the burdens placed on transactions by third-party closing opinions . . . is understandably high”.<sup>37</sup> In the next Part, I assess these skeptical views more systematically through a detailed examination of closing opinion practice, concluding based on available information that these views have significant merit and that the certification thesis cannot account adequately for the continued widespread use of closing opinions in sophisticated transactions.

II. *Identifying the Opinion Puzzle.* If confirmed, the standard certification thesis would easily account for closing opinion practice as another efficient mechanism for resolving informational asymmetries that would otherwise distort transactional pricing and structuring. To assess this proposition, I proceed in two steps. First, I review the typical scope of a closing opinion and describe the key procedural and cost burdens of the closing opinion process. Second, I evaluate factors that apparently dilute the incremental informational value of a closing opinion, including most notably the limited legal and reputational exposure typically assumed by

---

<sup>34</sup> See 2004 CALIFORNIA BAR REPORT, *supra* note \_\_, in GLAZER ET AL., at App. 9A:9-10. To be clear, the California bar committee states that, while it believes usage of closing opinions in certain transactions may not be cost-effective, it does not feel that the closing opinion in general is an “anomaly”. See *id.*

<sup>35</sup> See 2004 CALIFORNIA BAR REPORT, *supra* note \_\_, in GLAZER ET AL., at App. 9A:9-10.

<sup>36</sup> See TEXAS BAR REPORT, in GLAZER ET AL., *supra* note \_\_, at App. 21:78; MICHIGAN BAR REPORT, in GLAZER ET AL., *supra* note \_\_, at App. 17:8.

<sup>37</sup> See 2004 CALIFORNIA BAR REPORT, *supra* note \_\_, in GLAZER ET AL., at App. 9A:9-10.

opining law firms. On the basis of this discussion, an emergent puzzle takes shape: that is, subject to the inherent constraints of available information, the certification thesis does not adequately account for the widespread usage of closing opinions over a broad range of sophisticated transactional settings.

A. *Content.* A closing opinion is commonly requested and issued at the consummation of a variety of business transactions.<sup>38</sup> Delivery of the opinion letter is made to and at the request of one of the parties to the transaction and when requested is made a condition precedent to the “closing” of the transaction.<sup>39</sup> The most typical closing scenarios are (i) some private acquisition transactions (as distinguished from the acquisition of a publicly traded corporation)<sup>40</sup>; and (ii) most (probably almost all) substantial financing transactions.<sup>41</sup> While the broader category of legal opinions issued to third parties encompasses a variety of other settings, I will focus on so-called “classic” closing opinions issued to third parties in the context of an acquisition or financing transaction<sup>42</sup> and, unless otherwise indicated, will use the term “closing

---

<sup>38</sup> See GLAZER ET AL., *supra* note \_\_, at §1.1; ABA *Legal Opinion Principles*, *supra* note \_\_, at 192; ABA *Guidelines*, *supra* note \_\_, at 875.

<sup>39</sup> See 1998 TRIBAR REPORT, *supra* note \_\_; Bart Schwartz, *The case for in-house opinion letters: You don't have to go to outside counsel*, BUSINESS LAW TODAY, Vol. 11, No. 3 (Jan./Feb. 2002), available at [www.abanet.org/buslaw](http://www.abanet.org/buslaw).

<sup>40</sup> See GLAZER ET AL., *supra* note \_\_, at §1.1.

<sup>41</sup> See *id.*, at §1.2 n.2.

<sup>42</sup> More specifically, “closing opinion” as used in this Article excludes: title opinions, oil and gas opinions, “bond counsel” opinions, legality or similar opinions given in connection with a sale of securities, tax opinions, and “UCC” and perfection opinions. These opinions are generally agreed to fall outside the scope of the “classic” third-party legal opinion, see William Freivogel, *The Ethics and Lawyer Liability Issues Raised by Third-Party Opinion Letters*, in PRACTICING LAW INSTITUTE, LEGAL OPINIONS: THE IMPACT OF THE TRIBAR COMMITTEE'S NEW REPORT ON LEGAL OPINION PRACTICE 232 (1998). Analytically, these excluded opinions exhibit varying degrees of differential sophistication and legal distortion; as noted above, it is the substantial lack of these characteristics that allows for a reasonably “clean” analytical setting that isolate the factors that perpetuate “classic” closing opinions.

opinion” or simply “opinion” to refer solely to this particular (but the most common and most widely discussed) type of third-party legal opinion.

Irrespective of transactional setting, a closing opinion can best be described as a reasonable prediction based on professional knowledge of how courts in specified jurisdictions will rule on a particular legal question with respect to a certain set of facts.<sup>43</sup> The types of commonly issued opinions are highly standardized, almost all of which repeat (and almost never go beyond) the content of the representations and warranties made by the opining firm’s client in the principal transaction documents but with far fewer qualifications and disclaimers (if any).<sup>44</sup> The most widely issued opinion is a statement that the contractual obligations being assumed by the opinion issuer’s client are “valid, binding and enforceable” against it (the “enforceability” or “remedies” opinion).<sup>45</sup> Other familiar but substantially less commonly issued opinions (most of which support the core enforceability opinion) are described in the Table below. Any of these standard opinion formulations are generally accompanied by substantial qualifications, assumptions and disclaimers, which normally form the bulk of the opinion letter.<sup>46</sup> These standard qualifications—the most common of which are set forth in the Table below—considerably dilute the substantive force of the enforceability and other commonly included opinions. While the American Bar Association (the “ABA”) and the various regional bar

---

<sup>43</sup> See 1998 TRIBAR REPORT, *supra* note \_\_, at 2; *ABA Legal Opinion Principles*, *supra* note \_\_, at 192.

<sup>44</sup> See GRUSON ET AL., *supra* note \_\_, at 5; Ambro & Bidwell, *supra* note \_\_, at 310.

<sup>45</sup> See Michael Gruson, *Legal Opinions of New York Counsel in International Transactions*, 1989 COLUM. BUS. L. REV. 365, 366.

<sup>46</sup> See 1998 TRIBAR REPORT, *supra* note \_\_, at 3. On the assumptions and qualifications that commonly appear in legal opinions, see TRIBAR OPINION CMTE., *Special Report of the TriBar Opinion Committee: The Remedies Opinion—Deciding When to Include Exceptions and Assumptions*, 59 BUS. LAWYER 1483 (Aug. 2004) [hereinafter, *Special Report*].

associations regularly call for such qualifications to be used judiciously<sup>47</sup>, it is widely observed that many or even most practitioners use them liberally, employing what is sometimes derided as a “kitchen sink” approach.<sup>48</sup> A practitioners survey recently conducted by the Business Law Section of the California Bar confirms this impression, showing universal usage of a “laundry list” of exceptions and widespread usage of some more aggressive exceptions.<sup>49</sup>

---

<sup>47</sup> See, e.g., THE COMMITTEE ON LEGAL OPINIONS OF THE AMERICAN BAR ASSOCIATION’S SECTION OF BUSINESS LAW, *Guidelines for the Preparation of Closing Opinions*, 57 BUS. LAW. 876 (2002).

<sup>48</sup> See GLAZER ET AL., *supra* note \_\_, at §1.1 n.8, §3.2; 2004 CALIFORNIA BAR REPORT, *supra* note \_\_, in GLAZER ET AL., at App. 9A:88-89; *California Remedies Opinion Report*, *supra* note \_\_, at 925.

<sup>49</sup> See 2004 CALIFORNIA BAR REPORT, *supra* note \_\_, in GLAZER ET AL., at App. 9A:80-85 (out of survey sample of 35 California law firms (predominately mid-size to large-size), 100% report customary use of “laundry list” of exceptions in remedies opinion and 54% report customary use of more aggressive “generic exceptions” qualification).

**Table I: Standard Content of a Closing Opinion**

<u>Standard Opinion Formulations</u>	<u>Principal Exceptions and Other Limitations</u>
<ul style="list-style-type: none"> <li>• <i>Enforceability/Remedies Opinion</i>: Contractual obligations being assumed by client are enforceable against it.</li> <li>• <i>“No-Conflicts” Opinion</i>: Contractual obligations being assumed by client do not conflict with its existing contractual obligations or organizational documents.</li> <li>• <i>“No-Violations” Opinion</i>: Client’s performance of the relevant agreement(s) will not violate any applicable law.</li> <li>• <i>“No-Consents” Opinion</i>: Client’s performance of its contractual obligations does not require consent or approval of any governmental entity or other third party.</li> <li>• <i>Due Organization Opinion</i>: Relevant client entity is duly organized (that is, all required formation steps were properly taken under state law).<sup>50</sup></li> <li>• <i>Valid Existence Opinion</i>: Relevant client entity is legally existing on the date of the opinion letter.<sup>51</sup></li> </ul>	<ul style="list-style-type: none"> <li>• <i>Client information not independently verified</i>: Opinion assumes that all information provided by client is true and accurate without opining firm having undertaken any independent verification.</li> <li>• <i>Audience limitation</i>: Class of parties that may rely on the opinion is limited to the recipient and any additional specifically designated parties.</li> <li>• <i>No updating obligation</i>: Opinion is limited to the date on which it is issued; opining firm disclaims any obligation to update opinion in case of changes of law or fact.</li> <li>• <i>Equitable principles exception</i>: Enforceability may be limited by courts’ use of equity powers.</li> <li>• <i>Bankruptcy/insolvency exception</i>: Enforceability may be limited by federal bankruptcy laws.</li> <li>• <i>Clauses of doubtful enforceability</i>: Multiple specialized contractual clauses are noted to have inherently limited enforceability given uncertainty in existing case law.<sup>52</sup></li> <li>• <i>“Generic exception”</i>: General qualification that the enforceability of certain remedies may be limited (especially common in connection with loans).</li> </ul>

<sup>50</sup> A milder variation is the “due incorporation” opinion, which simply requires obtaining from the relevant Secretary of State a list of all filed charter documents and then reviewing those documents to confirm that the corporation has not been dissolved. *See* 1998 TRIBAR REPORT, *supra* note \_\_, at 49-51.

<sup>51</sup> This is usually rendered on of a certificate from the relevant state’s department of corporation. *See id.*, at 51.

<sup>52</sup> These include clauses such as: (i) “forum selection” clauses, *see Special Report, supra* note \_\_, at 1498-1503); (ii) waivers of the right to trial by jury, *see Special Report, supra* note \_\_, at 1493 n.51; and (iii) certain remedial provisions, especially relating to the attachment of assets by creditors in the case of a borrower default.

B. *Costs.* The issuance of a legal opinion (which generally follows detailed standing instructions updated periodically by the law firm’s opinions committee) is undertaken with significant care and review in the typical corporate law practice.<sup>53</sup> This internal review process, together with the research, preparation and sometimes extensive negotiation of closing opinions<sup>54</sup>, generate nontrivial direct and indirect costs. As observed by practitioners, from the perspective of a large corporate client, the most relevant cost is probably not monetary fees but rather the fact that preparation and negotiation of the opinion could delay closing and otherwise distract attention (often the attention of the most senior attorneys handling the transaction) from more substantive matters.<sup>55</sup> As is well-known among corporate-law practitioners, negotiation or finalization of closing opinions is often deferred until “the eve of closing” and can result in lengthy and arcane discussions among senior counsel to finalize the opinion language, thereby heightening these “distraction costs” and the possibility of a costly last-minute delay.<sup>56</sup> In certain transactions involving issues specific to foreign or out-of-state jurisdictions or particularly contentious factual issues, the opinion giver may require additional opinions from out-of-state counsel and/or officer’s certificates from the client’s management, all of which can generate additional costs and delays.<sup>57</sup> Other related costs

---

<sup>53</sup> See GLAZER ET AL., *supra* note \_\_, at §1.2.

<sup>54</sup> See 2004 CALIFORNIA BAR REPORT, *supra* note \_\_, in GLAZER ET AL., *supra* note \_\_, at App. 9A:6-7; Felton, *supra* note \_\_, at 52.

<sup>55</sup> See GLAZER ET AL., *supra* note \_\_, at §9.1.2 n.23; *California Remedies Opinion Report*, *supra* note \_\_, at 915; 2004 CALIFORNIA BAR REPORT, in GLAZER ET AL., *supra* note \_\_, App. 9A at 9A:47.

<sup>56</sup> See, e.g., 2005 CALIFORNIA BAR REPORT, *supra* note \_\_, at 20; Jeff R. Hudson et al., *Third Party Legal Opinions in Acquisitions of Privately Held Companies*, PRACTICING LAW INSTITUTE (June-July 2007), at 440.

<sup>57</sup> See Albert S. Pergam, *Transnational Opinions: Selecting and Collaborating with Foreign Counsel*, 1989 COLUM. BUS. L. REV. 413; Stephan Hutter, *The Corporate Opinion in International Transactions*, 1989 COLUM. BUS. L. REV. 427.

include the fixed costs incurred in order to sustain the law firm's opinion committee and the periodic review of a law firm's standing instructions with respect to opinion preparation,<sup>58</sup> which may be passed on to clients through higher billing rates. There is little available data on the precise fees generated solely or primarily by attorney hours spent on closing opinions, in part because these fees are generally folded into the total "billables" for the relevant transaction and a substantial portion of the supporting diligence behind an opinion is performed for other purposes in a typical transaction. A safe estimate, however, would probably settle on a range of several to tens of hours, which, assuming participation by associates and partners and an average hourly billing rate at a medium to top-tier national law firm of approximately \$200 to over \$800 depending on attorney seniority, office location and firm prestige<sup>59</sup>, translates into a dollar range of several to tens of thousands of dollars.<sup>60</sup>

C. *Value.* In this Section, I review multiple factors that may limit the incremental informational value of a closing opinion. These factors fall under three categories: (1) "obvious" limiting factors, which I believe should be uncontroversial among informed market practitioners and observers, (2) legal exposure, which I show is probably minimal in typical circumstances, a claim that I believe should be almost equally uncontroversial, and (3) reputational exposure, which I argue is substantially

---

<sup>58</sup> For a description of these costs, see Ambro & Bidwell, *supra* note \_\_, at 311.

<sup>59</sup> For a range of billing rates based on a 2006 National Law Journal survey, see *Firm-by-Firm Sampling of Billing Rates Nationwide*, 29 Nat'l. L. J. S2, Dec. 11, 2006. These numbers are probably an underestimate given that many of the highest-billing national law firms decline to take part in the National Law Journal survey.

<sup>60</sup> The distribution of fees within this range is not clear, although in routine transactions the fees presumably tend toward the lower end of the range. See Lipson, *supra* note \_\_, at 87 (noting that lawyers indicate that a closing opinion generally adds at least \$5000 to the transaction fee "and, depending on the type of transaction, substantially more").



limited in typical circumstances but recognize that this claim is subject to some uncertainty given inherent constraints on available information.

1. “*Obvious*” *Limiting Factors*. The “obvious” limiting factors are as follows: (i) limited substantive content, (ii) conflict of interest, and (iii) superior diligence alternatives. I will discuss each in turn. First, as noted above<sup>61</sup>, the abundant standard disclaimers and other qualifications considerably dilute the core opinion formulation, so much so that practitioners sometimes doubt whether the underlying opinion is “saying anything at all”<sup>62</sup>, some even raising the possibility that the opinion’s narrow scope produces a “largely useless product”.<sup>63</sup> Consider in particular the standard disclaimer that the opinion issuer assumes without independent verification the authenticity of all documents and the accuracy of all information provided to it: this means there is little assurance that, unbeknownst to the opining lawyer (who cannot rely on information that he or she knows, or has substantial reason to believe, to be untrue<sup>64</sup>), the opinion is based upon fraudulent or materially inaccurate information. Second, the opining law firm is subject to a conflict of interest given that its failure to issue an opinion would almost certainly terminate its relationship with its client at a crucial juncture (immediately prior to closing), thereby cutting off any future expected revenue stream and possibly

---

<sup>61</sup> See *supra* Tbl. 1 and notes [47] and [50] together with accompanying text.

<sup>62</sup> See Arthur J. Dillon, *Statement of Expectations of Counsel for Institutional Investors*, speech delivered at American College of Investment Counsel Annual Meeting, New York City, Sept. 15, 1988, reprinted in AMERICAN BAR ASSOCIATION, NATIONAL INSTITUTE, THE SILVERADO SUMMIT: THE STANDARDIZATION OF LEGAL OPINIONS – ORDER OUT OF CHAOS (1989).

<sup>63</sup> R. Bradbury Clark, *The Remedies Opinion*, printed in AMERICAN BAR ASSOCIATION, NATIONAL INSTITUTE, THE SILVERADO SUMMIT: THE STANDARDIZATION OF LEGAL OPINIONS – ORDER OUT OF CHAOS (1989) 3-9 (questioning expenditure of enormous time to negotiate certain opinions that result in a “largely useless product” given narrow scope).

<sup>64</sup> See RESTATEMENT LGL §95, Comment *e*; *ABA Legal Opinion Principles*, *supra* note \_\_, at 192.

alienating other actual and potential clients. Rhode Island has taken the view that this conflict is so strong that it now prohibits lenders from requiring that borrower's counsel render an enforceability opinion as a condition to closing.<sup>65</sup> Third, opining counsel may not be in any better position (and there may sometimes be reason to believe that it is in a *worse* position) than recipient's counsel to opine as to the enforceability of the relevant transaction documents and other fundamental legal matters.<sup>66</sup> Moreover, an opinion recipient usually has access to more robust diligence alternatives to verify the matters typically addressed by a closing opinion. In the case of any serious enforceability or other fundamental legal issues, the opinion recipient will rationally rely on a combination of (i) the non-conflicted advice of its own counsel<sup>67</sup>, who will spend considerable time reviewing the counterparty's relevant contractual and other documents, and (ii) the counterparty's express representations and warranties in the principal transaction documents<sup>68</sup>, which generally duplicate the standard enforceability, no-conflicts, no-

---

<sup>65</sup> See R.I. GEN. LAWS §19-9-7. The legislation apparently originated in a state Supreme Court ethics advisory panel opinion. See RHODE ISLAND SUPREME COURT ETHICS ADVISORY PANEL, GENERAL INFORMATIONAL OPINION NO. 3 (issued Mar. 1991).

<sup>66</sup> See *California Remedies Opinion Report*, *supra* note \_\_, at 912-13 (noting that the opinion recipient and its counsel are often more knowledgeable than the opinion giver about the matters covered in the opinion); Lipson, *supra* note \_\_, at 4 (noting views of interviewed attorneys that closing opinions often repeat information that "has or should come from a more authoritative source"); Schwarz, *Same Thing*, *supra* note \_\_, at 97-98 (noting that, in loan transactions, it is lender's rather than borrower's counsel who is in the best position to give an enforceability opinion given its greater familiarity with the loan documentation); Lipson, *supra* note \_\_, at 64 (making similar point with respect to enforceability opinions generally); 2004 CALIFORNIA BAR REPORT, *supra* note \_\_, in GLAZER ET AL., at App. 9A:40 (same).

<sup>67</sup> See 2004 CALIFORNIA BAR REPORT, *supra* note \_\_, in GLAZER ET AL., at App. 9A:9-10; 2005 CALIFORNIA BAR REPORT, *supra* note \_\_, at 22 (recommending that opinion recipient can sometimes forego opinion and rely on its own diligence investigation); 2004 CALIFORNIA BAR REPORT, *supra* note \_\_, in GLAZER ET AL., at App. 9A:40 (noting that "[i]n the vast majority of transactions, a third-party remedies opinion does not result in the identification of enforceability issues unknown to the opinion recipient or its counsel").

<sup>68</sup> 2004 CALIFORNIA BAR REPORT, *supra* note \_\_, in GLAZER ET AL., at App. 9A:9-10; 2005 CALIFORNIA BAR REPORT, *supra* note \_\_, at 22 (recommending that opinion recipient can sometimes forego opinion and rely on appropriate representations and warranties in the underlying agreement).

violations and due organization opinions<sup>69</sup> while being encumbered with far fewer qualifications and assumptions (if any) and sometimes supported by specific contractual indemnities and supporting escrow, deferred payment or other enforcement mechanisms.

2. *Legal Exposure.* A lawyer undertakes to exercise “ordinary skill and knowledge” when serving clients and failure to do so can provide grounds for negligent malpractice, negligent misrepresentation or other claims.<sup>70</sup> Given the erosion of common-law privity barriers, this negligence standard now normally covers legal opinions issued to non-client third-parties.<sup>71</sup> In addition to a negligence claim filed by an opinion recipient, there are a number of other formal sanctions to which an attorney could be subject as a result of having issued a negligent or otherwise defective opinion. These include: disciplinary action by state authorities under state bar association rules<sup>72</sup>, a common law fraud action<sup>73</sup>, “aiding and abetting” claims<sup>74</sup>, a civil conspiracy suit and

---

<sup>69</sup> See Mark Suchman & Mia Cahill, *The Hired Gun as Facilitator: Lawyers and the Suppression of Business Disputes in Silicon Valley*, 21 L. & SOC. INQ. 679, 694-96 (1996) (arguing that opinion letters in venture-capital transactions are “informationally superfluous” because they just restate representations and warranties that have already been negotiated by the client)..

<sup>70</sup> See John P. Freeman, *Current Trends in Legal Opinion Liability*, 1989 COLUM. BUS. L. REV. 235, 242; Howe, *supra* note \_\_, at 290. “Ordinary skill and knowledge” is defined by reference to the customary practices of other similarly situated attorneys. See 1998 TRIBAR REPORT, *supra* note \_\_, at 6.

<sup>71</sup> This barrier has disappeared with respect to direct recipients of legal opinions, although in certain important jurisdictions such as New York and Texas, this was not definitively settled until 1992 and 1999 respectively. See *Prudential Ins. Co. v. Dewey, Ballantine Bushby, Palmer & Wood*, 590 N.Y.S.2d 831, 605 N.E. 2d 318 (1992); *McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests*, 991 S.W.2d 787 (Tex. Ct. App.) (1999).

<sup>72</sup> See RESTATEMENT LGL §95, Comment (a) (stating that “[a] lawyer is subject to professional discipline for failure to comply with professional rules governing evaluations to a third person . . . such as when a lawyer knowingly makes a material misstatement of fact to a third person”); AMERICAN BAR ASSOCIATION, CENTER FOR PROFESSIONAL RESPONSIBILITY, ANNOTATED MODEL RULES OF PROFESSIONAL CONDUCT (2004) [hereinafter, ABA RULES OF PROFESSIONAL CONDUCT] (noting that the lawyer issuing an opinion is at risk of a disciplinary proceeding “if in the course of making the evaluation he or she violates applicable ethics obligations”).

<sup>73</sup> Under state common law of fraud, lawyers generally have a duty not to knowingly or recklessly make material misrepresentations or conceal information when the lawyer has a duty to disclose and the

securities-law violations.<sup>75</sup> Despite this laundry list of potential liability horrors, several factors suggest (and the practitioner literature tends to agree<sup>76</sup>) that the legal exposure typically assumed by an opining firm is relatively low in typical circumstances.

The reason is straightforward: any negligence or similar claim against an opining firm must overcome the abundant qualifications, assumptions and disclaimers that protect the core opinion formulation. Far from empty words, these qualifications are litigation-tested barriers that courts generally respect, thereby shielding the opining attorney from potential liability. In judicial decisions involving closing opinions and other legal opinions<sup>77</sup>, courts generally respect the standard qualifications, such as the “equitable principles” exception<sup>78</sup>, the “bankruptcy and insolvency” limitation<sup>79</sup>, the qualification

---

other party has a right to rely. See Donald C. Langevoort, *Where Were the Lawyers? A Behavioral Inquiry into Lawyers' Responsibility for Clients' Fraud*, 46 VAND. L. REV. 75, 83 (1993) [hereinafter Langevoort, *Where Were the Lawyers?*].

<sup>74</sup> Attorneys can be held liable for assisting in the fraudulent scheme of a client, provided certain *scienter*, conscious intent and, in some jurisdictions, fiduciary relationship requirements are met. See *id.*, at 84-86.

<sup>75</sup> In the securities context, attorneys could theoretically be subject to liability for a “primary violation” of Rule 10b-5 of the Securities Exchange Act of 1934, which relates to fraud concerning the purchase or sale of a security. See 1998 TRIBAR REPORT, *supra* note \_\_, at 9. However, there are two practical limitations: (i) any 10b-5 claim would require proof of *scienter* (which has the important effect of excluding negligence-based claims), and (ii) under the Supreme Court’s decision in *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164 (1994), a private plaintiff cannot bring a 10b-5 aiding and abetting claim against an attorney. With respect to (ii), the practical effect of *Central Bank of Denver* has been eroded substantially in most circuits by alternative theories of “primary violation”, “scheme liability” and other arguments. See Matthew L. Mustokoff, “‘Scheme’ Liability Under Rule 10b-5: The New Battleground in Securities Fraud Litigation”, 53 FED. LAWYER 20 (2006).

<sup>76</sup> See Freedman, *supra* note \_\_, at 252; Ambro & Bidwell, *supra* note \_\_, at 308; Freivogel, *supra* note \_\_, at 232 and, with respect to acquisition transactions, Felton, *supra* note \_\_, at 53.

<sup>77</sup> By “other legal opinions”, I mean to indicate that the ensuing discussion concerning courts’ treatment of typical opinion disclaimers draws in part on case law involving legal opinions other than closing opinions, it being reasonably assumed that a court adjudicating a case involving a closing opinion would draw by close analogy on this related jurisprudence.

<sup>78</sup> See, e.g., *Washington Elec. Coop. Inc. v. Massachusetts Municipal. Wholesale Elec. Co.*, 894 F.Supp. 777 (D. Vt. 1994) (finding that statement in opinion letter that legal obligations were subject to judicial discretion absolved lawyer from any liability for not predicting changes in the law).

<sup>79</sup> See *TriBar Remedies Opinion*, *supra* note \_\_.

noting failure to independently verify information provided by the client<sup>80</sup>, the qualification limiting the opinion to the laws of specified jurisdictions<sup>81</sup> and the audience limitations specified in almost all opinion letters.<sup>82</sup>

The dilutive force of these standard qualifications yields the prediction that an opining firm's legal exposure is relatively low in the case of a typically formulated opinion letter. The legal and insurance trade literature concurs, observing that courts generally are reluctant to impose liability on opining attorneys<sup>83</sup>, reflected by the fact that cases involving closing opinions are infrequent, summary judgment in favor of law-firm defendants is frequently granted and decisions finding opining lawyers ultimately liable are rare.<sup>84</sup> To confirm this view independently (as well as to obtain greater detail on

---

<sup>80</sup> For cases upholding such disclaimers, see *Mark Twain Kansas City Bank v. Jackson, Brouillette, Pohl & Kirley, P.C.*, 912 S.W.2d 536 (Mo. Ct. App. 1995) (finding that sophisticated lender represented by counsel could not have justifiably relied on factual statements in opinion letter in light of adequate disclaimer stating that the opining firm took no responsibility for information in the letter and declining to "read in" missing language that would limit disclaimer to a no-updating obligation); *Fortson, Winstead, McGuire, Sechrest & Minick*, 961 F.2d 469 (4<sup>th</sup> Cir. 1992) (issuance of opinion clearly limited to tax matters imposed no duty on opining firm to verify veracity of financial data provided to it by client or to reveal in the opinion client's past troubled commercial ventures). *But see Kline v. First W. Gov't Secs., Inc.* 24 F.3d 480 (3d Cir. 1994) (finding that statement that opinion based on assumed facts does not bar Rule 10b-5 liability under federal securities laws when lawyer had good reason to know of a material inaccuracy given long close relationship with seller), *cert. denied*, 115 S.Ct. 613 (1994). At least one court has since criticized the *Kline* decision. See *In re Infocure Sec. Litig.*, 210 F.Supp.2d 1331, 1359 (N.D. Ga. 2002) (following dissent in *Kline* and stating that there is "no compelling public policy justification for disregarding disclaimers in third-party opinion letters" in complex transactions involving sophisticated parties with independent counsel).

<sup>81</sup> See, e.g., *Resolution Trust Corp. v. Latham & Watkins*, 909 F.Supp. 923 (S.D.N.Y. 1995) (finding that lawyer who issued opinion letter relating solely to Florida law issues was not liable for failing to discuss the law of other states). For additional discussion, see Gruson, *supra* note \_\_, at 366-67; 1998 TRIBAR REPORT, *supra* note \_\_, at 4, 38; *ABA Legal Opinion Principles*, *supra* note \_\_, at 193.

<sup>82</sup> See Howe, *supra* note \_\_, at 294. For an indicative decision, see *Merkel v. Livestock Breeders Int'l of New Jersey, Inc.*, 1988 WL 66864 (D.N.J. 1988) (ruling that a disclaimer as to the class of reliant parties can preclude a finding that a representation was made to the plaintiff or that the plaintiff reasonably relied on the alleged representation).

<sup>83</sup> See Freeman, *supra* note \_\_, at 235 (noting that courts are reluctant to impose liability on lawyers for opinions); *Ambro & Bidwell*, *supra* note \_\_, at 308 n.3 (same); *Freivogel*, *supra* note \_\_, at 4 (noting a "benign legal climate" for third-party opinions).

<sup>84</sup> See *Freivogel*, *supra* note \_\_, at 227 (stating that the number of reported decisions involving third-party legal opinions is "incredibly small").

historical trends), I surveyed the Westlaw database of reported federal and state court decisions from 1986 through 2006, supplemented by a search for additional relevant cases referenced in the practitioner literature, and identified federal and state court decisions involving suits against law firms that had issued closing opinions in connection with an acquisition or loan transaction.<sup>85</sup> These findings, summarized in the Table immediately below, are consistent with the aforementioned view.<sup>86</sup>

---

<sup>85</sup> To be clear, for purposes of this search and the Table below, the definition of “classic” third-party legal opinion has been used, as described previously. *See supra* note [42] and accompanying text.

<sup>86</sup> The specific cases are listed in *Appendix I*. Note that opinion-related cases often raise multiple other claims involving the same and/or co-defendants; as a result, there cannot be complete certainty that all judicial decisions involving closing opinions in acquisition or financing transactions during the relevant period have been located. Where there was ambiguity as to whether a specific decision fell within this Article’s definition of “closing opinion”, the case was included. Additionally, note that the identified cases include (and extend substantially beyond) all cases identified in the only prior published systematic review of the relevant case-law record through 1998, *see* Freivogel, *supra* note \_\_, at Appendix (other than a single case involving a no-liens opinion, which has been excluded given its proximity to a “UCC” opinion, which is generally not included under the rubric of a “classic” closing opinion). For a discussion of the prior study by a leading commentator on legal opinions, see Arthur N. Field & Jeffrey M. Smith, *Legal Opinions in Business Transactions* (PRACTICING LAW INSTITUTE, Nov. 2005), § 3-2.

**Table II: Identified Decisions Involving Closing Opinions  
in Loan and Acquisition Transactions (1986-2006)**

<b>Period</b>	<b>Total reported decisions</b>	<b>Reported decisions per year</b>	<b>Number and percentage of decisions that grant summary judgment<sup>87</sup></b>	<b>Number of decisions involving enforceability opinions; percentage that grant summary judgment</b>	<b>Decisions where opining firm ultimately found liable</b>	<b>Geographic distribution of reported decisions</b>
1986-2002	17	1.06	7 (41%)	7 (71%)	0 (0%)	<i>NY: 5/17 Conn.: 2/17 Texas: 1/17 Other: 9/17</i>
2003-06	14	3.5	6 (43%)	5 (60%)	2 (14%)	<i>NY: 5/14 Conn.: 2/14 Mass.: 3/14 Texas: 1/14 Other: 3/14</i>
Total (1986 - 2006)	31	1.55	13 (42%)	12 (67%)	2 (.07%)	<i>NY: 10/31 Conn.: 4/31 Mass.: 3/31 Texas: 2/31 Other: 12/31</i>

As the Table indicates, over the 20-year period from 1986 through 2006, judicial decisions relating to closing opinions are infrequent (between one and two decisions per year on average) and dismissed at summary judgment in more than one-third of all such cases. Additionally, in litigations involving the “core” enforceability opinion (more than one-third of all decisions involving closing opinions), summary judgment has been granted to the defendant more than two-thirds of the time.<sup>88</sup> While there has been an historically significant upsurge in

<sup>87</sup> Where some opinion-related claims against an attorney were dismissed on summary judgment and some were remanded to the trial court, I categorized the litigation as *not* having been dismissed on summary judgment.

<sup>88</sup> By way of comparison, a Federal Judicial Center study, using a sample of 3600 federal district court cases in selected jurisdictions, found the following percentage rates for civil cases terminated by summary judgment: 7.7% in 2000 and approximately 6% in 1995 and 5% in 1990. See Joe S. Cecil et al., *Trends in Summary Judgment Practice: A Preliminary Analysis*, DIV. OF RESEARCH, FED. JUDICIAL CENTER (Nov. 2001).

litigation starting in 2003, it appears possibly to be a short-lived effort by plaintiff attorneys to test judicial receptiveness to opinion-based claims in the charged post-Enron climate<sup>89</sup> and most such cases are concentrated in the New York, Connecticut and Massachusetts courts. In any case, even these courts have acted consistently with historical tendencies. Defendants' summary judgment motions are still granted at high rates and the post-2002 decisions have not yielded any substantive rulings that shift the generally lenient standards of relevant case-law<sup>90</sup>, in which case there is probably little basis to believe that opining firms' legal exposure has increased materially.

This view must be qualified by the fact that low judgment rates may not reflect higher settlement rates, although relevant trade commentary does indicate that settled claims are infrequent<sup>91</sup> and available data shows low reported claim rates in the broader category of all legal opinions.<sup>92</sup> Consistent with this limited litigation activity, the practitioner literature almost uniformly advises that it would be imprudent for an opinion recipient to rely on any reasonable

---

<sup>89</sup> This flurry of opinion-related litigation may have specifically followed Judge Melinda Harmon's refusal in 2002 to dismiss claims against Vinson & Elkins, Enron's principal external counsel, in the Enron litigation, in part due to the fact that Vinson & Elkins had issued opinion letters in connection with certain of Enron's structured-finance transactions. See Memorandum and Order Re Secondary Actors' Motion to Dismiss filed December 20, 2002 in [In re Enron Corp. Sec., Derivative and ERISA Litig., 235 F. Supp. 2d 549 \(S.D. Tex. 2002\)](#), Civil Action No. H-03-3624, Consolidated Cases. Plaintiffs in this litigation have since dropped these claims against Vinson & Elkins. See Brenda Jeffreys, *Texas Court Dismisses Vinson and Elkins from Enron Shareholders' Suit*, THE LEGAL INTELLIGENCER, Jan. 30, 2007.

<sup>90</sup> See Richard M. Zielinski, *Differences of Opinion*, LAW FIRM PARTNERSHIP & BENEFITS REPORT (Aug. 2005) (reviewing recent opinion-related litigation and arguing that these cases "do not break any significant new legal ground" but may limit opining firm's ability to rely on "to our knowledge" and "without investigation" qualifiers); Lisa K. Bruno, *Opinion letter pitfalls: Don't get bitten*, MASS. LAWYERS WEEKLY (Mar. 28, 2005) (same). See also ABA SECTION OF BUSINESS LAW COMMITTEE ON LEGAL OPINIONS, LEGAL OPINION NEWSLETTER, Vol. 4, No. 2 (Mar. 2005) (statement by Arthur Field, leading commentator, that much-discussed *Dean Foods* decision in Massachusetts "makes no new law, merely confirming established customary practice obligations").

<sup>91</sup> See Freivogel, *supra* note \_\_\_, at 230-31; 2004 CALIFORNIA BAR REPORT, in GLAZER ET AL., *supra* note \_\_\_, at App. 9A:12 n.21.

<sup>92</sup> A 2003 ABA study notes that only 179 opinion-related claims (excluding claims relating to title opinions but including all claims relating to all other legal opinions) were filed against law firms during 2000-2003, 48 claims were filed during 1996 to 1999 and 66 claims were filed during 1986 to 1995. See AMERICAN BAR ASSOCIATION, STANDING CMTE ON LAWYERS' PROFESSIONAL LIABILITY, PROFILE OF LEGAL MALPRACTICE CLAIMS 7, tbl. 3 (2003).



prospect of monetary recovery against a lawyer who negligently issued a legal opinion.<sup>93</sup>

Judicial decisions concerning closing opinions and other legal opinions appear to be guided by the view that opinions, as subjective professional judgments, should be strictly distinguished from (and relied upon to a significantly lesser degree than) objective representations of fact<sup>94</sup>, which in turn has generated the proposition that an opining attorney's error should not give rise to liability if the opinion reflects the lawyer's informed judgment.<sup>95</sup> Even in more ambiguous cases, courts generally make efforts to protect opining lawyers who become entangled with a client's fraudulent behavior, absent compelling evidence of the lawyer having consciously rendered substantial assistance to the relevant scheme.<sup>96</sup> Notwithstanding the general rule that lawyers cannot rely on information that they know, or have substantial reason to believe, to be untrue, even lawyers who have made only a minimal factual investigation when rendering an erroneous opinion have successfully escaped malpractice liability.<sup>97</sup> Cases where a law firm has

---

<sup>93</sup> See, e.g., Schwartz, *supra* note \_\_ (stating that “any comfort derived from the assumption that the recipient of a misleading opinion letter can recover damages from the law firm that rendered it may prove illusory, since litigation against law firms on opinion letters is rare” and that case law tends to support the conclusion that “opinions are not of significant value for the legal remedies they provide to opinion recipients”).

<sup>94</sup> See, e.g., Washington Electric Cooperative, Inc. v. MMWEC and consolidated cases, 894 F.Supp. 777, 790 (D. Vt. 1994) (rejecting plaintiffs' breach of warranty claim in connection with an allegedly inaccurate legal opinion, and stating further that the court has “searched in vain for a case in which an attorney has been sued successfully on a breach of warranty theory for representations made in an ‘opinion letter’. Based on their very title, these documents defy plaintiffs' efforts to characterize them as factual guarantees”).

<sup>95</sup> See Beeson, *supra* note \_\_, at 139.

<sup>96</sup> For a description of these cases, see Freeman, *supra* note \_\_, at 250-52. See, e.g., In re Citisource, Inc. Securities Litigation, 694 F.Supp. 1069 (S.D.N.Y. 1988) (finding no liability on the part of the lawyer rendering a legal opinion to an underwriter on behalf of a corrupt issuer on the ground that the law firm did not engage in any culpable misconduct and declining to adopt the “novel proposition” that “the mere fact of its status as issuer counsel permits a strong inference of recklessness”). See generally Langevoort, *Where Were the Lawyers?*, *supra* note \_\_, at 87 (stating that “when the attorneys are not actually responsible for preparing the communications containing the misstatements or omissions—for instance, where they simply prepared contracts or closing materials—there is a strong tendency [among courts] to find insufficient assistance on which to impose liability”).

<sup>97</sup> See, e.g., First Interstate Bank of Nevada, N.A. v. Chapman & Cutler, 837 F.2d 775 (7<sup>th</sup> Cir. 1988) (finding no malpractice liability where law firm rendered inaccurate opinion in connection with bond issue based on certain hypothetical facts, assumed to be true without further investigation and later determined to be inconsistent with actual facts); Abell v. Potomac Insurance Co., 858 F.2d 1104 (5<sup>th</sup> Cir. 1988) (finding no malpractice liability where counsel to the underwriters in a bond offering had rendered an opinion concluding that nothing had come to the law firm's attention indicating that there was any misstatement or omission in the offering prospectus (although the law

been sued or held liable for a closing opinion (or other legal opinion) generally involve either an omission by the opining attorney of such qualifying language<sup>98</sup>, inclusion by the opining attorney of uncustomary “factual” representations, active involvement by the attorney in a client’s scheme<sup>99</sup> or simply representation of a client that happened to be engaged in fraud, which then *incidentally* leads to the attorney being targeted under an aiding and abetting theory.<sup>100</sup> In the latter category, the closing opinion is just one of several elements used by the claimant to show the lawyer’s involvement in the alleged fraud, for which he or she would most likely have been sued whether or not an opinion had been issued, in which case the opinion may have had little marginal effect on the attorney’s legal exposure.

Even in the unlikely scenario where a plaintiff has a strong negligence or similar claim against an opining firm, it faces an unattractive litigation target. To see why, observe that legal exposure is a function not only of governing legal precedent but of the available assets that may be accessed by plaintiffs to satisfy any judgment, *net* of the costs of obtaining judgment and then enforcing it. A strong claim against an asset-poor client (or alternatively, a strong claim against an asset-poor client that will require litigation expenditures in excess of the anticipated damages award) is practically meaningless. This statement can easily describe even a well-grounded claim against even a well-established opining firm. First, given the attorney-friendly case-law history, the legal fees incurred in connection with obtaining judgment against a law firm that issued a typically qualified opinion are likely to be substantial and, absent an unusual fee-shifting award, will capture a substantial portion of any final judgment. Second, given that all but a

---

firm had invested few resources in investigating the truth of statements in the prospectus), with grounds for the court’s decision being, in part, insufficient evidence of actual participation in the issuer’s fraudulent scheme).

<sup>98</sup> See Howe, *supra* note \_\_, at 307.

<sup>99</sup> See Freedman, *supra* note \_\_, at 252.

<sup>100</sup> See Freivogel, *supra* note \_\_, at 230-32.

handful of even the most elite national law firms are now organized as limited-liability partnerships<sup>101</sup>, the available asset pool is typically limited by the cap on the law firm's malpractice insurance policy, which, while it may be substantial in absolute terms, will effectively be reduced by any legal fees incurred by the law firm in connection with the litigation, and, in any case, may be insubstantial in relative terms when compared to the far richer asset pools that could be targeted by an aggrieved counterparty in a high-stakes transactional setting. Plaintiffs' attorneys in the Enron shareholder class action apparently reached precisely this conclusion, electing to drop claims against the Texas law firm of Vinson & Elkins, apparently because the available compensation under the firm's malpractice policy was insufficient to justify the necessary legal fees to pursue final judgment, especially when compared to the far deeper corporate pockets of some of the other defendant parties.<sup>102</sup>

3. *Reputational Exposure.* Even assuming that the opining firm typically has a relatively low expectation of legal liability, it may fairly be argued that this observation partially misses the point insofar as a practitioner's expectation of reputational liability for inaccurate opinions is likely to be far more significant.<sup>103</sup> Following the certification thesis, retention of a prestigious

---

<sup>101</sup> See Robert W. Hillman, *Organizational Choices of Professional Service Firms: An Empirical Study*, \_\_ BUS. LAWYER \_\_ (2003). I note that the relevant statutes usually preserve residual levels of personal liability even for partners in law firms that adopt the LLP form, although these levels are among the lowest in such major jurisdictions as New York and Texas. See Susan Saab Fortney, *Professional Responsibility and Liability Issues Related to Limited Liability Partnerships*, S. TEX. L. REV. 399, 404 (1998).

<sup>102</sup> See Brenda Jeffreys, *Texas Court Dismisses Vinson and Elkins from Enron Shareholders' Suit*, THE LEGAL INTELLIGENCER, Jan. 30, 2007 (quoting judge's statement that "the court recognizes the right of the lead plaintiff to control its suit, to streamline it for trial, and to pursue the 'deepest pockets' without expending further time and money on defendants from which it does not expect to be able to collect substantial funds"). Apparently Vinson & Elkins did agree to certain cash settlements in connection with the Enron bankruptcy litigation. See *Vinson & Elkins, Enron Reach Settlement*, HOUSTON BUSINESS J., June 2, 2006.

<sup>103</sup> See Coffee, *Comment*, *supra* note \_\_, at 61-62 (noting that, when issuing a closing opinion, the opining law firm's reputational liability exposure is likely to be of greater concern than its legal liability exposure, principally due to ability to limit legal liability exposure through use of disclaimers).

law firm sends a credible signal regarding its client's contracting quality because the law firm is unlikely to have a rational incentive to risk hard-earned reputational capital by assisting in any individual fraudulent action. It therefore follows that a law firm should be highly sensitive to reputational damage for issuing an erroneous opinion, which in turn implies that a closing opinion from any repeat-player law firm should offer significant assurance with respect to the matters it addresses, even in the absence of any meaningful legal penalty for doing so negligently or erroneously.<sup>104</sup> But this argument relies on two unstated assumptions: namely, it must be true that (1) law firms generally play a meaningful function as a "reputational intermediary"<sup>105</sup> and (2) issuance of an inaccurate opinion actually causes substantial reputational damage to the opining firm. It is not clear that either assumption is generally justified.

As a practical matter, the "lawyer as reputational intermediary" thesis may be substantially overstated with respect to at least current corporate-law practice, where sophisticated clients may value law firms primarily as a means of obtaining vigorous negotiation services, astute transactional design, specialized legal guidance or accurate documentation of business agreements rather than as a bonding mechanism to demonstrate contracting quality to any potential counterparty.<sup>106</sup> Some lawyers say so themselves: a 2004 report issued by an ABA

---

<sup>104</sup> Some would replace "even in" with "precisely because of". See Arnoud Boot, Stuart Greenbaum, and Anjan Thakor, *Reputation and Discretion in Financial Contracting*, 83 AMER. ECON. REV. 5 (1993) (arguing that legal nonenforceability may be a precondition for enabling a promisor to accrue reputational capital by voluntarily adhering to "discretionary" commitments). For reasons discussed in the text above, it is unclear whether law firms contribute meaningful levels of incremental reputational capital to business transactions and even if this were the case, whether an erroneous opinion (and therefore, refusing to "honor" an opinion) would cause the law firm material reputational injury. However, Boot et al.'s argument may have an alternative application in the closing-opinion context insofar as it could provide the basis for arguing that the increase in perceived legal liability of opining firms starting in the early 1970s undermined the reputational force that may have once stood behind opinion letters.

<sup>105</sup> For skeptical treatments of the reputational intermediary thesis with respect to legal services, see Langevoort, *Where Were the Lawyers?*, *supra* note \_\_, at 112; George M. Cohen, *When Law and Economics Met Professional Responsibility*, 67 FORDHAM L. REV. 273, 287-89 (2003).

<sup>106</sup> See Langevoort, *Where Were the Lawyers?*, *supra* note \_\_, at 112; Coffee, *Understanding Enron*, *supra* note \_\_, at 1405.

“task force” (on securities-law opinions) *expressly rejects* the proposition that an opining lawyer acts as a reputational intermediary with respect to its client.<sup>107</sup> In particular, two historically novel characteristics of the current legal market probably erode the reputational value of external legal counsel: (1) larger corporations have virtually abandoned the “permanent retainer” model and often use multiple external counsel on a rotating basis that gives each firm limited opportunity to gain intimate knowledge of the client<sup>108</sup>; and (2) as a result of internal growth and acquisitions, leading corporate law firms typically employ several hundreds of lawyers in multiple offices, making it difficult for any such firm to credibly monitor the actions of all its partners and associates.<sup>109</sup> Moreover, any residual reputational capital that may be attributed to external counsel has limited *incremental* value in sophisticated transactional settings, given that: (i) on the “buy-side”, a business party often has ample capacities to independently perform a rigorous diligence process with respect to any possible counterparty<sup>110</sup> and (ii) on the “sell side”, a business party often is itself a repeat-player in the relevant market and therefore has substantial incentives to safeguard reputational capital through good-faith behavior. The declining

---

<sup>107</sup> See Special Report of the Task Force on Securities Law Opinions, ABA Section of Business Law, *Negative Assurance in Securities Offerings*, 59 BUS. LAWYER 1513, 1515-16 (Aug. 2004).

<sup>108</sup> See COFFEE, *supra* note \_\_, at 194. For a related point, see Ronald J. Gilson, *The Devolution of the Legal Profession*, 49 MD. L. REV. 869, 900-03 (1990) [hereinafter, Gilson, *Devolution*] (arguing that increased sophistication of law firm clients has reduced a law firm’s market power (by reducing costs of switching law firms) and in turn reduced a law firm’s ability to act as a gatekeeper).

<sup>109</sup> See Schwarcz, *To Make or To Buy*, *supra* note \_\_. Other commentators have argued that large size *increases* reputational capital by making it less likely that the relevant firm will risk injuring its extensive operations in order to enjoy gains on a single fraudulent action. See J. Bradford DeLong, *Did J.P. Morgan’s Men Add Value? An Economist’s Perspective on Financial Capitalism*, in KLEIN, *supra* note \_\_, at 195-96. The argument above is not inconsistent insofar as it recognizes that large size also *reduces* reputational capital insofar as the market appreciates that a larger firm has less capacity to monitor the actions of its employees, who as nominal owners do not share a similar interest in safeguarding the reputational capital of the firm as a whole. Which effect prevails is an open empirical question.

<sup>110</sup> See Okamoto, *supra* note \_\_, at 19-20 (noting that reputational value of outside lawyers has been reduced as a result of lower costs of information verification, which can now be handled more easily by clients internally). For a similar observation with respect to stock exchange listings, see Jonathan Macey & Maureen O’Hara, *Stock Transfer Restrictions and Issuer Choice in Trading Venues*, 55 CASE W. RES. L. REV. 587 (2005) (arguing that an exchange listing now has reduced reputational value given the ability of institutional investors to monitor the performance of companies in which they are invested or may invest).

incremental value of law firms' reputational capital is reflected by the increasing substitution of external counsel by internal counsel in non-specialized transactional functions as well as the virtually universal adoption by even the most elite law firms of limited-liability organizational forms<sup>111</sup>: both phenomena would presumably be less prevalent if clients attributed unique reputational value to outside counsel.<sup>112</sup>

These observations are broadly consistent with the few empirical efforts to confirm the reputational value of law firms, which are confined to the securities offering context and find mixed or no support outside of a limited set of elite firms.<sup>113</sup> Even if it were nonetheless assumed that law firms *do* contribute substantial reputational capital to sophisticated business negotiations, there is no reason to conclude that issuance of an erroneous opinion would necessarily cause substantial reputational injury to the opining firm. Contrary to the required

---

<sup>111</sup> See Okamoto, *supra* note \_\_, at 43 (noting that migration to LLP organizational form constitutes “disinvestment” in the reputational value of the firm).

<sup>112</sup> I grant that firms could still ascribe positive marginal reputational value to outside counsel but either (i) take the view that any such value is exceeded by the cost-savings enjoyed by bringing certain legal services “in house” or (ii) “go in-house” at higher or lower rates in different transactional settings where external counsel has higher or lower marginal reputational value. However, it seems to me the continued retention of external counsel for large-scale and/or highly complex transactions or customized regulatory advice is primarily driven by the non-cost-effectiveness on the client-side of maintaining what would be an often idle inventory of legal personnel and/or highly specialized intellectual capital.

<sup>113</sup> See Okamoto, *supra* note \_\_ (based on data concerning retention of legal counsel in sample of securities offerings from January 1993 through December 1995, finding that the reputational value of external counsel is declining during relevant period outside of a small group of elite firms, which solely represent the most established securities issuers); Beatty & Welch, *supra* note \_\_, at 576-85 (showing that IPO underpricing and underwriter compensation falls when issuers hire more expensive law firms and interpreting this result to mean that elite law firms provide either improved quality assurance or superior negotiation in setting terms with issuer). As suggested by Beatty & Welch's second alternative, these results could be construed as a professional (rather than a moral) variant of the reputational intermediary thesis: that is, these data could support a correlation between a reputation for honesty and firm prestige and/or a correlation between a reputation for high-quality work product and firm prestige. Additionally, note that the securities offering context involves an issuer and multiple dispersed investors, a substantially different transactional environment than an acquisition or financing transaction in which closing opinions are normally issued and the counterparties have extensive prior interaction; in the latter scenario, the business parties have ample opportunity to conduct diligence, thereby reducing the relative value of any reputational capital pledged by an external legal advisor. See also Schwarcz, *To Make or to Buy*, *supra* note \_\_ (surveying general counsels and finding that majority attributes reputational value to outside counsel but only small minority attributes substantial reputational value; I note that Schwarcz appears to use “reputational value” primarily to mean professional competence rather than moral trustworthiness).

assumptions of the certification thesis, there is no clear empirical evidence that perceived misconduct by a law firm will consistently result in a swift market penalty (which, working backwards, will then deter any such behavior in the first place). Several law firms that have been sued or found liable for negligently issued opinions or been accused of gross unethical conduct have apparently suffered little if any long-term damage to their prestige or ability to retain or attract clients.<sup>114</sup> I preliminarily confirmed further the sedate reaction of the reputational market to allegedly negligent opinion-giving by searching Westlaw news databases (including local practitioner journals) for articles concerning the litigations identified in Table II above (and Appendix I); generally, there is little coverage (if any) beyond a one-time description of the relevant decision<sup>115</sup> and no mention of any actions taken by the relevant law firm that are normally indicative of reputational injury in the commercial context (e.g., resignations, public announcements of changed policies, etc.). This pattern is consistent with sleepy market reactions to more dramatic allegations of law-firm malfeasance in other legal-opinion contexts. In 1972, the Securities & Exchange Commission (“SEC”) brought a widely-noted securities fraud action against the law firm of White & Case (and one of its partners) for alleged involvement in a client’s fraudulent merger and related securities transaction, including issuance of a closing opinion<sup>116</sup>; however, there is no evidence the law firm suffered any serious decline in prestige or

---

<sup>114</sup> See Lipson, *supra* note \_\_, at 57 (noting that White & Case, Hale & Dorr and Vinson & Elkins have been or are involved in litigation concerning possible liability for negligently issued opinions and are still considered prestigious firms). See generally Langevoort, *supra* note \_\_, at 112 (arguing that law firms likely suffer little reputational damage when found to have been involved in the fraudulent conduct of a client).

<sup>115</sup> The sole exception appears to be *Banco Popular North America v. Gandi*, a 2004 New Jersey Supreme Court decision, which primarily concerned a “creditor fraud” claim against an attorney who advised a delinquent borrower on an allegedly fraudulent asset transfer, in the context of which it issued an allegedly misleading legal opinion. The press coverage relates primarily to the possible expansion of attorney liability to non-clients, and not to the particular law firm involved in the relevant litigation. See, e.g., Robert B. Hille, *Duty to Non-Clients: Banco Popular Raises Double Exposure*, N.J. Lawyer, Vol. 13, No. 1 (Jan. 5, 2004).

<sup>116</sup> See *Securities & Exchange Comm’n v. National Student Marketing Corporation et al.*, 402 F.Supp. 641 (1975).

other economic injury as a result. And more recently, the Texas law firm of Vinson & Elkins has apparently emerged largely unscathed from its close involvement in the Enron scandal, especially after having been dismissed as a defendant from the pending Enron shareholders' class action, in which it had become ensnared largely as a result of having issued "true sale" and "non-consolidation" opinion letters in connection with certain structured-finance transactions.<sup>117</sup>

This state of affairs is not altogether surprising. Even when a law firm is sued for having allegedly issued a negligently prepared opinion, the suit may be seen as having little merit (for example, the White & Case enforcement action mentioned above was widely criticized in the New York bar<sup>118</sup>), may not be widely publicized or, even if widely publicized, may be credibly attributable to an "honest mistake" or a "rogue" attorney not indicative of the firm's general practice as represented by its hundreds of other lawyers.<sup>119</sup> The same factors that compromise a law firm's reputational value generally speaking also support the weaker claim that, even if law firms do retain some meaningful reputational function, issuance of a perceived erroneous legal opinion inflicts little reputational injury given the large size of the typical national law firm (thereby limiting its known capacity to monitor and restrain attorney conduct) and, in many or most cases, the lack of any long-term relationship between external counsel and its client (thereby limiting its known capacity to verify client-supplied information). The resulting "noise"

---

<sup>117</sup> See Michael Orey, *Enron's Last Mystery*, BUSINESS WEEK, June 12, 2006. On dismissal, see *supra* note \_\_\_. On the opinion letters in particular, see Mike France, *What About Enron's Lawyers*, BUSINESS WEEK, Dec. 23, 2002.

<sup>118</sup> See *Report of the New York City Bar Association Task Force on the Lawyer's Role in Corporate Governance – November 2006*, 62 BUS. LAW. 427 (2007).

<sup>119</sup> See Kraakman, *supra* note \_\_\_, at 100 (noting that reputation is a "noisy" signal, which can limit the deterrent effect of reputational penalties on gatekeeper misconduct); Cohen, *supra* note \_\_\_, at 287-89 (arguing that it is often difficult to assess law firms' reputational capital, it is often ambiguous whether bad results should be attributed to lawyers' misconduct or negligence and large law firms can often attribute any misconduct or negligence by one of its lawyers to a "bad apple" without casting serious aspersions on the firm's reputation). See generally Choi, *supra* note \_\_\_, at 10 (noting that, in the securities intermediary context, there is an "observability problem" with respect to intermediary quality insofar as it is often difficult to ascribe investment failure to auditor or analyst error, since a wide range of other plausible explanations for an adverse business outcome may exist).



surrounding the substantive content of a closing opinion may substantially insulate a law firm from reputational injury in connection with even highly adverse transactional outcomes. Given the foregoing considerations and barring cases in which a client is obviously engaged in criminal or fraudulent activities with a client, it is unclear whether a sophisticated market assesses a meaningful reputational penalty against a reputable firm that “happened” to issue a closing opinion in connection with the nefarious schemes of a client who had otherwise appeared to be a reputable enterprise.

*D. Evaluation: The Puzzle Emerges.* On a theoretical level, the certification thesis puts forward a straightforward account of efficiency benefits accruing from, and therefore the widespread use of, closing opinions in business transactions. But theory must ultimately rest on some empirical basis. As described above, the closing opinion process generates nontrivial costs, including most notably the opportunity costs relating to a potential delay in consummating a transaction typically having a value in the tens or hundreds of millions of dollars together with diverting limited attorney resources in the sensitive period immediately prior to closing. It would therefore be expected that closing opinions would typically confer nontrivial benefits by materially reducing informational asymmetries among contracting parties, thereby generating efficiency gains by modifying the price or transactional design so as to better reflect underlying asset values. So long as these anticipated efficiency gains typically exceed anticipated resource expenditures on the closing opinion process, there would be no curiosity at all. Consistent with some practitioners’ impressions, the discussion above casts substantial doubt on the incremental informational value typically yielded by a closing opinion, thereby raising the possibility that opinion-related expenditures may at least sometimes fail a cost-benefit test, in which case the

continued widespread use of closing opinions *does* become curious. While the certification thesis would presumptively identify the closing opinion as a typically effective quality proxy, close examination shows this assumption to rest on shaky ground. Given an opinion's minimal substantive content, an opinion giver's constrained liability exposure, the availability of robust diligence alternatives and other limiting factors, it seems unlikely that a sophisticated attorney or business client ever relies on a conventionally hedged closing opinion to allay material doubts concerning enforceability or other fundamental matters. Any other policy would be imprudent: courts have expressly admonished (or disbelieved) sophisticated parties who claimed to have done so, refusing to honor the closing opinion precisely in the contingency for which, following the certification thesis, it is issued! In a decision that vividly illustrates this point, a Michigan appeals court ruled that a lender's reliance on a closing opinion that later proved to be inaccurate was not justifiable because the lender, as a sophisticated party, was aware that the issue of authority covered by the opinion was in dispute and elected to close the transaction anyway.<sup>120</sup> It may be equally striking to learn that there is no assurance that a closing opinion can estop the opining firm's client from later contesting the enforceability of the relevant transaction, which is precisely the core issue purportedly being "certified".<sup>121</sup>

At best, a typical closing opinion appears to provide its recipient with a positive but minimal level of incremental information with respect to the counterparty's contracting quality.

---

<sup>120</sup> See *City National Bank of Detroit v. Rodgers & Morgenstein*, 399 N.W. 2d 505 (Mich. App. 1986). For a similar ruling, see *Greyhound Leasing & Fin. Corp. v. Norwest Bank*, 854 F.2d 1122 (8<sup>th</sup> Cir. 1988) (ruling that a lender's negligence in not investigating lien status precluded lender from bringing negligence claim against opining law firm that relied solely upon its client's representations without conducting a lien search).

<sup>121</sup> See CALIFORNIA 2004 REMEDIES OPINION REPORT, *supra* note \_\_, in Glazer et al., at App. 9A:44-46 (rejecting notion that issuance of enforceability opinion bars client from later contesting enforceability of the relevant agreement, but adding that there may be an informal estoppel benefit insofar as the opinion could limit reasonable latitude in settlement negotiations to contest the enforceability of the relevant agreement); Schwarcz, *Limits of Lawyering*, *supra* note \_\_, at 11 n.55 (same, but stating that issuance of an opinion may still hamper the opining attorney's client from later contesting the relevant transaction).

Recall that the strength of a quality signal depends on the extent to which the costs of obtaining the signal are substantially greater for lower-quality parties relative to higher-quality parties, such that generally only the latter can afford to supply the signal, which in turn permits higher-quality parties to distinguish themselves from lower-quality parties. But an opinion is *not* substantially more costly for all but the lowest-quality parties to obtain relative to higher-quality parties that occupy the remaining portion of the contracting quality spectrum. Given the wide array of limiting factors discussed above, together with the constrained screening resources and capacities of even a well-established law firm, both the high-quality client with a pristine business record and the somewhat unsavory client with a significantly less than pristine history (but still lying above the criminal or otherwise distasteful level) can probably obtain the services of a prestigious law firm, assuming only sufficient financial resources.<sup>122</sup> As a result, it appears that the opinion does not typically transmit anything more than a weak quality signal that tells the recipient *something but very little* about where its potential business partner lies on the contracting quality spectrum, doing nothing more than allowing opinion recipients to distinguish between extremely low-quality counterparties and the undifferentiated remainder.

The certification thesis would only offer a *complete* explanation for currently robust levels of closing opinion practice if all of the following propositions were true: (1) closing opinions generally contain meaningful substantive content, (2) law firms take on significant legal and/or reputational exposure in issuing an opinion (and therefore would only issue opinions on behalf of clients that exhibit confirmed high contracting quality) and (3) opinion recipients do not already have access to more robust diligence instruments. The certification thesis would

---

<sup>122</sup> A similar observation has been made with respect to the informational value of letters of credit. See Clayton Gillette, *Letters of Credit as Signals*, 98 MICH. L. REV. 2537, 2543 (2000) (arguing that the quality signal provided by a letter of credit is opaque because both an applicant with pristine credit and an applicant that just passes the creditworthiness threshold will have its letter of credit application approved by the issuing bank).

offer a *partial* explanation for current levels of closing opinion practice if at least the second and third propositions were true (this explanation would be partial because it could not immediately account for the typical opinion's highly diluted content). Based on the foregoing discussion, the first proposition is almost certainly unfounded (that is, it should be uncontroversial that the substantive content of most closing opinions is highly limited), the second proposition is highly unlikely with respect to legal exposure and subject to serious doubt with respect to reputational exposure (that is, opining lawyers probably do not assume significant legal exposure and most likely do not assume more than limited reputational exposure), and the third proposition is usually untrue in sophisticated business transactions (that is, opinion recipients usually do have access to alternative robust diligence alternatives). It is therefore difficult to confidently attribute anything more than minimal certification value to a typically qualified closing opinion, which in turn yields a reasonable likelihood that the expenditures devoted to preparing and negotiating it may at least sometimes fail the cost-benefit condition assumed by the standard certification thesis.<sup>123</sup>

---

<sup>123</sup> Assuming constant costs, it may appear that a closing opinion would be more likely to pass a cost-benefit test at high transaction values, where it may be "worth it" to expend resources on even a minimally informative closing opinion. But even this is not clear. Suppose a transaction fails in part due to an enforceability issue addressed by the closing opinion, generating catastrophic losses. Even in this worst-case scenario, it is not clear that the aggrieved counterparty will devote *any* litigation resources to suing the opining attorney. That is because (i) given existing case law, it will be difficult to obtain a favorable judgment, which in turn will generate substantial legal fees, which, absent an unusual fee-shifting order, will capture part of the final judgment, (ii) assuming typical organization as a limited-liability partnership, the law firm's liability is effectively capped by its malpractice insurance, and (iii) the insurance cap probably pales in comparison to the attachable assets of the law firm's corporate client (in which case, it is precisely in the highest-value transactions that the aggrieved counterparty may conclude that it is *not* worth it to sue on the opinion). (Incidentally, these appear to be precisely the reasons why the shareholder plaintiffs in the Enron class action elected to drop Vinson & Elkins from the suit, see *supra* note \_\_\_\_.) For further discussion, see *supra* notes 101-102 and accompanying text.

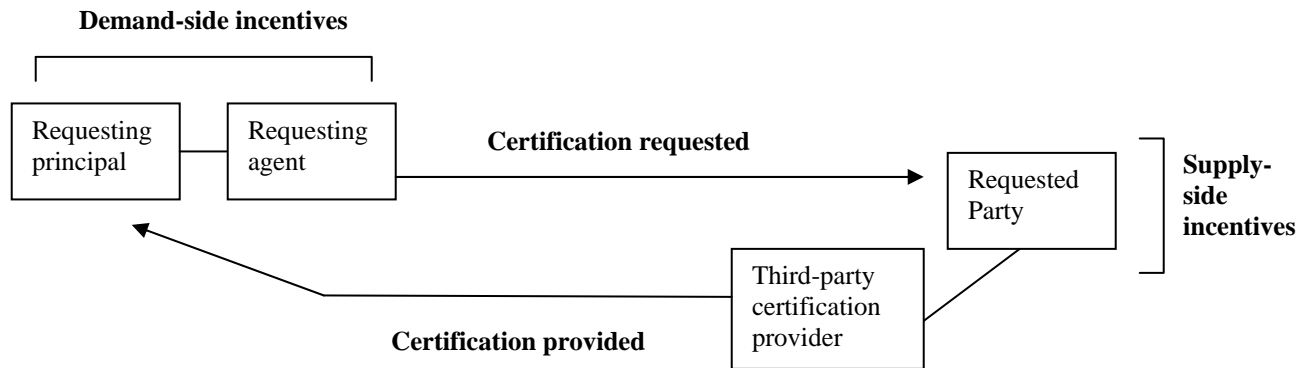
III. *Solving the Opinion Puzzle.* At this point, the emergent opinion puzzle should be clear: it is subject to serious doubt whether closing opinions typically yield significant certification benefits but yet rational economic actors are willing to expend nontrivial resources on obtaining them in a broad range of business transactions. In this Part, I address this puzzle by identifying an incentive structure that would induce a requesting party to request a closing opinion and a requested party to satisfy any such request, independent of the parties' belief as to whether this exercise is cost-justified. This structure consists of two components, which operate in sequence: (i) an agency-cost effect on the demand-side, where an agent acting on behalf of the requesting party is exposed to distorted incentives to make a standard certification request; and (ii) an adverse-selection effect on the supply side, where the requested party is exposed to distorted incentives to satisfy any standard certification request. On the demand side, the requesting agent is rationally biased to conform to entrenched certification practice in order to avoid any reputational penalty for perceived professional incompetence and, given its nominal or zero ownership in the principal (and zero ownership in the counterparty), is rationally indifferent to all or almost all of the costs of doing so.<sup>124</sup> On the supply side, assuming the certification instrument is easily available to a broad (but not the entire) range of transacting parties and has been entrenched as standard practice, requested parties are rationally biased to satisfy any certification request (through the third-party certification provider) in order to avoid a punitive

---

<sup>124</sup> This claim relates to the extensive literature on agency costs and resulting distortions in project selection. For a foundational analysis of how agents' career concerns yield underinvestment in risky projects, see Bengt Holmstrom, *Managerial Incentive Problems: A Dynamic Perspective*, 66 REV. ECON. STUD. 169 (1999). Two specific contributions are especially relevant to the discussion above. See Todd L. Milbourn, Richard L. Schockley & Anjan V. Thakor, *Managerial Career Concerns and Investments in Information*, 32 RAND J. ECON. 334 (2001) (showing how a manager's reputational incentives can lead to overinvestment in information acquisition with respect to possible investments); David S. Scharfstein & David C. Stein, *Herd Behavior and Investment*, 80 AMER. ECON. REV. 465 (1990) (showing that managers may have incentives to accrue reputational capital by "following the crowd" and as a result, some managers may forego actions having positive net expected value if there is a substantial risk of being judged less talented by the labor market in the event the action proves to be erroneous).

quality discount for failure to do so.<sup>125</sup> Together these demand-side and supply-side incentives can support rational overconsumption of a minimally informative and non-cost-justified certification instrument. The Figure below depicts this incentive structure, which is then described more fully in the following discussion.

**Figure I: Generic Two-Sided Incentive Structure**

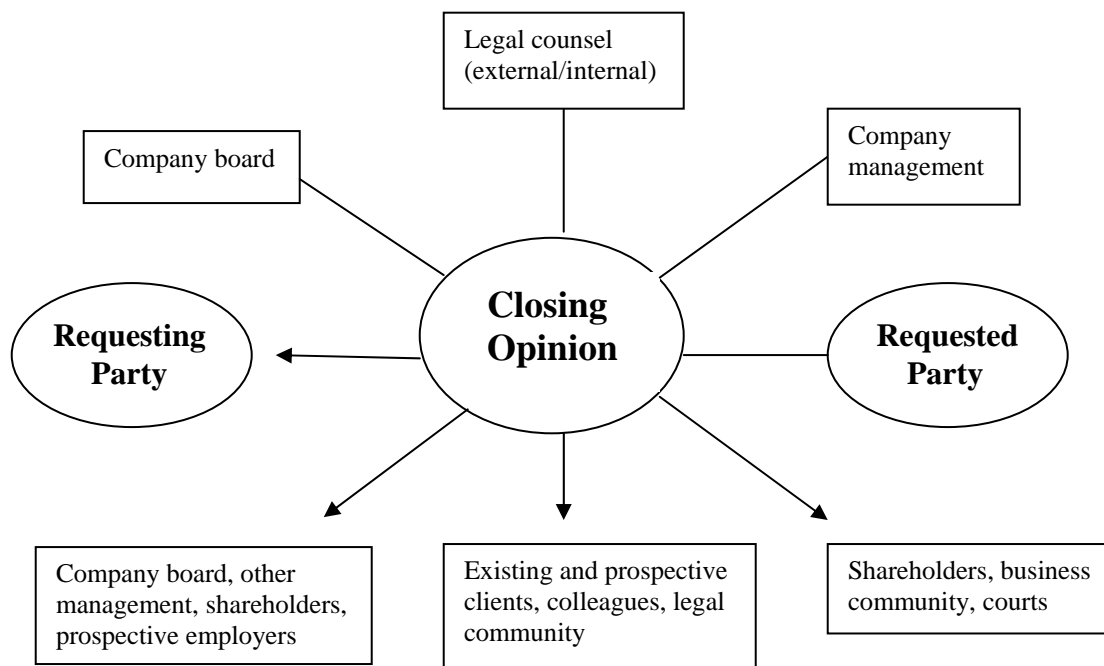


<sup>125</sup> This claim relates to the economic literature on excessive signaling outcomes. The seminal source is found in the “unproductive” signaling models developed by Michael Spence in the education context, *see supra* note [15] and accompanying text. For more specific applications, *see* Danny Ben-Shahar, *Productive Signaling Equilibria and Over-Maintenance: An Application to Real Estate Markets*, 28 J. REAL ESTATE FIN. & ECON. 2 (2004) (arguing that, as a result of adverse-selection effects, sellers of real-estate, or other durable assets where quality is imperfectly observable, may overinvest in improvements in order to signal quality to potential buyers); Charles F. Mason & Frederic P. Sterbenz, *Imperfect Product Testing and Market Size*, 35 INT’L ECON. REV. 61 (1994) (arguing that introduction of inaccurate product quality certification can aggravate “lemons problem” (i.e., causing further exit of higher-quality sellers) where test cost exceeds incremental additional revenues from undergoing certification and noting that higher-quality sellers who remain in the market will nonetheless incur certification costs because failure to do so would result in even greater reduction in revenues); Philippe Aghion & Benjamin Hermalin, *Legal Restrictions on Private Contracts Can Enhance Efficiency*, 6 J. L. ECON. & ORG. 381 (1990) (arguing that, in the absence of restrictions on contractual penalties for breach, entrepreneurs with “good” projects are forced to signal excessively in order to avoid being perceived as “bad”, whereas, when contractual penalties for breach restricted, they may be better off to the extent they are perceived as “average” but save on signaling costs); Nahum D. Melumad & Lynda Thoman, *On Auditors and the Courts in an Adverse Selection Setting*, 28 J. ACCTG. RES. 77 (1990) (arguing that, even if auditors provide uninformative reports, a company will rationally obtain these reports because not doing so (assuming most other companies also do so) would result in lenders viewing the company as a high risk rather than an average risk).

A. *Demand-Side Incentives.* The requesting party faces the following choice: if the anticipated informational value obtained by adhering to the certification convention exceeds the anticipated certification costs, then conform to convention (i.e., request the certification); otherwise deviate (i.e., do not request the certification). As a practical matter, the requesting party makes this election indirectly through its agent (whether a lawyer, manager or board director). In turn, the requesting agent makes this election while being subject to anticipated evaluation in an internal or external “reputation market” where it is assessed penalties for perceived incompetence and rewards for perceived competence in making its election whether to conform or deviate from convention (e.g., request or not request an opinion).<sup>126</sup> As illustrated in the Figure below, while the closing opinion (or other relevant certification) is ostensibly issued between two counterparties, it transmits information concerning the professional competence of the requesting agent to a collateral set of reputation markets: (i) in the case of a manager, to other managers, shareholders, the company board and prospective employers, (ii) in the case of a director, to shareholders, the business community and even courts, and (iii) in the case of a lawyer, to colleagues, the legal community, and existing and prospective clients.

---

<sup>126</sup> If, as argued above, the reputation market does not regularly assess penalties for opinion-related litigation against law firms, it may seem unlikely that the reputation market would regularly assess penalties for individual lawyers’ deviation from an opinion-requesting convention. However, the “noise” that surrounds collective law-firm misbehavior is considerably “louder” than the “noise” that surrounds individual lawyer misbehavior, given that (i) only the former can be attributed to monitoring costs (the “rogue employee” defense) or lack of knowledge (the “devious client” defense), and (ii) deviations from a “bright-line” norm (“always request an opinion”) are easier to detect (and harder to contest) than deviations from a fuzzy standard of good-faith conduct.

**Figure II: Reputation Markets**

If socially preferred action could be costlessly enforced, the requesting agent would elect to conform only so long as the incremental informational value of the opinion exceeds certification costs, in which case any non-cost-justified certification instrument would disappear from the market. However, the requesting agent is inherently liable to violate this cost-benefit test. There are two reasons. First, provided the agent holds a zero ownership interest in the counterparty (always the case) and less than a substantial ownership interest in its principal (typically the case and almost always the case for an attorney), it is rationally indifferent to all of the costs incurred by the counterparty and most (or even all) of the costs incurred by the principal in connection with the certification process.<sup>127</sup> As a result, the agent is virtually

<sup>127</sup> For this purpose, certification costs incurred by the principal refer both to (i) certification costs allocated directly to the principal (e.g., legal fees paid by lender to its counsel) and (ii) certification costs that are allocated directly to the counterparty (e.g., legal fees paid by borrower to its counsel) to the extent these are borne indirectly by the principal (e.g., the counterparty's costs are reflected in the negotiated price or other deal terms or reduce the counterparty's ability to perform its contractual obligations).



indifferent to any cost-savings that may be enjoyed by deviating from convention. Second, the agent is uniquely exposed to reputational rewards and penalties that will be assessed against it in the relevant reputation markets for perceived professional competence or incompetence in connection with any deviation from conventional practice that is perceived to be, respectively, successful or erroneous. Together these factors generate a disproportionate risk-allocation to the benefit of the principal and the detriment of the agent: while the anticipated cost-savings and other economic gains from a successful deviation are entirely or almost entirely allocated to the principal (and the counterparty), the anticipated reputational losses from an erroneous deviation are entirely allocated to the agent. Subject to the assumption, as argued immediately below, that these anticipated reputational losses typically exceed the anticipated reputational gains from a contemplated deviation<sup>128</sup>, this asymmetrical relationship between a low upside in the case of a “good” deviation and high downside in the case of a “bad” deviation logically drives the agent to “play it safe” and conform to standard practice, even if doing so is neither socially cost-justified nor cost-justified from the perspective of the principal.<sup>129</sup>

---

<sup>128</sup> Note that this assumption is subsequently relaxed in the case of certain “lead” market participants, which then allows for the possibility that the market will independently correct a non-cost-justified certification practice. See *infra* Part IV.

<sup>129</sup> For excerpts from attorney interviews that echo the discussion above, see Lipson, *supra* note \_\_, at 114-115. For a similar argument with respect to lawyers’ incentives in rendering advice on the legal risks of a particular transaction, see Ribstein, *supra* note \_\_, at 1709-10 (arguing that because lawyers suffer harm in the form of reputation and malpractice liability in the case of a bad result for the client but do not share in the client’s gain in the case of a good result, they prefer to adhere to standard practice and standard forms); Langevoort & Rasmussen, *supra* note \_\_, at 378-79 (noting “an asymmetry in the observability of good and bad advice that leads naturally to an incentive to err on the side of caution”) and 396-97 (arguing that potential reputational penalties for transactions gone awry lead attorneys to overstate legal risks). For a similar argument in the contracting context, see Kahan & Klausner, *Path Dependence*, *supra* note \_\_, at 354-55 (arguing that the failure of an incorrectly formulated contract term weighs more heavily in a lawyer’s reputational payoff than the success of a correctly chosen term, for which the attorney is generally not given any “extra credit”, and therefore, standardized terms will be preferred over customized terms in drafting given that they have a lower variance of potential outcomes). On this point more generally, see Gilson, *Devolution*, *supra* note \_\_, at 892 (arguing that lawyers have an incentive to err on the side of overinclusion in drafting and negotiating contractual provisions insofar as reducing such provisions to a more reasonable scope is unlikely to be observable by clients).

Given that the agent is rationally indifferent to any potential cost-savings (in which it holds a nominal or insubstantial stake) and rationally sensitive to any potential reputational losses or gains (in which it holds an undiluted stake) from any contemplated deviation, its behavior is easily anticipated: so long as the anticipated net reputational payoff for deviating is negative, the agent will shield its reputational capital by rationally conforming to standard practice, even if doing so fails to generate informational value in excess of certification costs. Whether this inefficient outcome—what I call an “agency-cost distortion”—is practically realized then depends on whether the requesting agent typically attributes a negative value to the net reputational payoff for electing to deviate. There are three familiar scenarios in the legal and managerial setting where this would reasonably be the case. First, the requesting agent may anticipate that deviating will immediately trigger a reputational penalty to the extent that the relevant market believes the attorney, manager or director exhibited ignorance or imprudence by failing to follow customary practice. Illustrating these pressures, a typical justification that attorneys offer when requesting an opinion is simply that “it is market”<sup>130</sup> – meaning: other lawyers are obtaining the opinion in similar transactions and therefore *not* insisting on it would expose the attorney to reputational penalties for perceived incompetence. Second, if the relevant transaction is consummated but ultimately generates an adverse outcome for the principal and a causal link plausibly exists between the adverse outcome and the agent’s failure to conform to convention, the agent is likely to suffer a substantial penalty for incompetence for what is perceived to be an erroneous deviation from industry practice. Third, while clients (or other managers) will be eager to *shift* reputational liability to the requesting agent who erroneously deviated, they will be eager to *appropriate* reputational gains from the requesting agent who

---

<sup>130</sup> See *California Remedies Opinion Report*, *supra* note \_\_\_, at 912.

successfully deviated, thereby magnifying reputational losses in the case of an erroneous deviation and diluting reputational gains in the case of a successful deviation.<sup>131</sup> Interestingly, virtually all these scenarios can operate collectively to generate multiple-order agency-cost distortions: for example, a corporate manager may follow convention and request an opinion in order to limit the anticipated reputational penalty for a perceived erroneous deviation, a rationale that may in part be supported by the fact that the corporation’s law firm has advised the manager that it is “prudent” or “customary” to request an opinion, which the law firm itself may have given based on the same incentives to limit *its* reputational downside.

Taken as a whole, this analysis provides a rational-choice explanation for the stereotypical figure of the overly cautious lawyer or junior manager: largely unexposed to cost-savings or other economic benefits in the case of a successful deviation from convention but fully exposed to reputational penalties in the case of an erroneous deviation, the agent literally “errs on the safe side”, rationally insisting on strict adherence to standard procedure even if doing so is not cost-justified from the perspective of the principal. It is important to note, however, that this rational conservatism relies strictly on the assumption that the requesting agent at least partially discounts the certification costs borne by the requesting principal. To the extent that the requesting principal institutes reasonably effective monitoring or other corrective mechanisms, the agent may not fully discount the certification costs borne by the principal (e.g., an attorney may consider the client’s certification costs in order to avoid a reputation for “overlawyering” and an in-house lawyer may consider the employer’s certification costs in order

---

<sup>131</sup> I note also that the agent’s conformity incentives may be bolstered further to the extent it believes that any “base” reputational penalty for perceived incompetence that it otherwise suffers in the event of an adverse business outcome would be mitigated by the fact that it had undertaken all customary diligence procedures. See GLAZER ET AL., *supra* note \_\_, at §1.3.2 (noting judicial decisions where the court used evidence of an opinion having been obtained as the grounds on which to find that the board took the requisite level of care in approving a particular transaction). There are grounds for this view under the Delaware corporate code, which provides that a board member may be fully protected in relying in good faith upon “information, opinions, reports or statements” presented to the board by any competent expert. See DEL. CORP. CODE §141(e).

to avoid internal sanctions for permitting the accrual of large legal bills). In this case the agency-cost distortion would be mitigated and any degenerate certification practice would be expected to disappear more rapidly from the market.

B. *Supply-Side Incentives.* Demand-side incentives only solve half of the opinion puzzle, for it can obviously be argued that, even assuming that agency-cost pressures regularly induce requesting agents to request a non-cost-justified certification, this does not resolve the matter because the convention would ultimately *not* be sustained so long as requested parties refuse to satisfy an “unnecessary” formality. While this is not an implausible possibility, it may be the exception in transactional settings where closing opinions are routinely granted as a matter of standard practice and widely available to a transacting population occupying a broad (but not the entire) portion of the contracting-quality spectrum. The intuition behind this claim is as follows: if the certification is available to all parties other than extreme low-quality parties, then failure to satisfy a certification request logically causes the requesting party to apply a punitive transaction discount to reflect the implication that the counterparty belongs to the extreme low-quality segment.<sup>132</sup> While a requested party’s customary willingness to provide a standard and widely available certification transmits a weak “affirmative” quality signal, *uncustomary*

---

<sup>132</sup> For examples of other inefficient market conventions persisting due to similar “involuntary” implications, see Donald C. Langevoort, *Organized Illusions: A Behavioral Theory of Why Corporations Mislead*, 146 U. PA. L. REV. 101, 115-16 (1997) (arguing that, where it has become the norm for corporations to engage in “puffery”, a corporation that elects to deviate from the norm and provide truthful disclosure may suffer a disproportionate penalty insofar as the market will interpret truthful disclosure as an indication that a seriously adverse situation has materialized); Walter Kamiat, *Labors and Lemons: Efficient Norms in the Internal Labor Market and the Possible Failures of Individual Contracting*, 144 U. PA. L. REV. 1953 (1996) (arguing that the standard practice of at-will employment may persist inefficiently because, given the presence of shirking employees, no employer can offer “just cause” employment without attracting such employees and even non-shirking candidates cannot negotiate for a just cause provision without raising the implication of being a shirking candidate); Omri Ben-Shahar, *On the Stickiness of Default Rules*, 33 FLA. ST. L. REV. 651 (2006) (arguing that parties may not opt out of inefficient default rules, even when superior alternative can be identified and formulated at negligible cost, because counterparty will suspect that deviation from norm is indication of “secret” bad intentions).

insistence on *not* providing the certification transmits a strong “negative” quality signal, implying that there is some highly problematic fact that has not been disclosed to the requesting party. Hence, absent exorbitant certification costs, even a high-quality counterparty whom is being asked to issue an opinion rationally conforms to convention in order to avoid the anticipated transactional discount for failing to do so, independent of its belief as to whether or not the relevant instrument is cost-justified.

Let’s explore this claim in greater detail, in particular for the purpose of identifying at least some of the conditions that must be satisfied for this result to be realized in practice. Faced with an opinion (or other certification) request, the requested party will grant it so long as the pricing gains for providing the opinion plus the avoided transaction discount for failing to do so exceed the certification costs allocated to it. If we assume that pricing gains monetize on a “dollar-for-dollar” basis the incremental informational value of the requested certification, then the requested party should elect to conform so long as the incremental informational value plus the avoided transaction discount exceed the certification costs allocated to it. Now assume for analytical convenience that the requested party’s contracting quality is entirely unknown, in which case the requesting party initially assigns the requested party a contracting quality equal to the average quality of the total counterparty population.<sup>133</sup> If we then assume (consistent with the discussion above) that the closing opinion is available to all potential counterparties other than an extreme low-quality segment, the incremental informational value conveyed by the opinion will simply be the difference between the average quality of the total counterparty population and the average quality of the total counterparty population *excluding* the extreme low-quality segment. That is: the opinion simply confirms that the requested party occupies a

---

<sup>133</sup> As used in this discussion, the “average” value is understood to be weighted as required to reflect the perceived proportions of lower-quality and higher-quality types in the counterparty population.

position somewhere within the large undifferentiated population of potential counterparties who lie above the opining firm's "cutoff point" for delivery of an opinion. Assuming (consistent with the discussion above) that the extreme low-quality segment that lies below the cutoff point represents a small to nominal proportion of the total counterparty population, this difference is minimal and delivery of the opinion yields little upward adjustment to the perceived quality of the requested party. As a result, the requested party can expect to accrue few pricing gains by providing the opinion and, depending on the certification costs allocated to it, might be inclined to decline the certification request. However, it will rationally avoid this temptation, for in the event the requested party did *not* provide the opinion and thereby saved on certification costs, it would likely suffer even greater pricing *losses*. This is because failure to provide the opinion will tend to drive the agent to conclude that the requested party belongs to the extreme low-quality segment that lies below the cutoff point, which it will then "price in" by applying an appropriate discount to the deal consideration. This downward adjustment will simply be the difference between the average quality of the total counterparty population and the average quality of the extreme low-quality segment.<sup>134</sup> So long as the extreme low-quality segment is believed to be sufficiently "bad" relative to the "remainder" higher-quality population, this discount will be large and the counterparty will rationally incur the costs of providing the requested certification in order to avoid the even greater cost that would be incurred by "killing the deal" or reducing the deal consideration.

This analysis identifies an interesting relationship. Paradoxically (and subject to the assumptions stated above), as the incremental informational value of the certification instrument

---

<sup>134</sup> Note that a more complex formulation would reduce the value of this discount by a certain factor to reflect the requesting party's belief that some deviating counterparties may be higher-quality parties who lie above the cutoff point but do not wish to provide the opinion on the "principled" grounds that it is a wasteful convention. This belief may be more plausible, and the discount would then be decreased accordingly, in the case of established firms with respect to which there are other reliable indications of contracting quality.

(the “affirmative” quality signal) falls to minimal but still positive levels such that it does nothing but exclude a small sub-population consisting of the most extreme low-quality counterparties, the transaction discount assessed for failing to provide it (the “negative” quality signal) increases, up to and including failure to consummate the relevant transaction. (If the informational value *does* reach zero, then the conformity incentive disappears since failure to honor a certification request would by necessity have no negative quality implication and the transaction discount would then fall to zero). By analogy, consider a law school professor who is known to give “A” grades to 95 out of every 100 students: the grade conveys minimal incremental information to a prospective law-firm employer concerning its holder’s future performance prospects since almost all of the candidate population has it; however, given its widespread dissemination, any student who fails to obtain the “A” grade incurs a drastic quality discount that blocks even preliminary consideration in the hiring process (assuming employers believe that students who do not receive “A” grades have sufficiently inferior talents relative to students who do receive “A” grades). Similarly, in the typical case where a closing opinion has low incremental informational value but is widely used among the relevant transacting population (and requesting parties believe that counterparties who cannot obtain opinions are sufficiently inferior to counterparties who can obtain opinions), a requested party who declines to conform to standard practice may generate a substantial discount or even endanger a transaction having a value in the tens or hundreds of millions of dollars. Thus, barring astronomical certification costs, even a high-quality counterparty rationally grants a customary opinion request so as to avoid the drastic implication that its contracting quality lies on the extreme end of the contracting-quality spectrum. This outcome persists independently of the requested party’s belief as to whether the relevant instrument is socially cost-justified.

IV. *Fixing the Opinion Puzzle.* The agency-cost distortion that sustains (in part) a non-cost-justified certification practice necessarily assumes that the requesting agent does not assign a sufficiently high value to the expected net reputational payoff upon deviating from convention (i.e., in the typical case, this value is assumed to be negative). In this Part, I argue that this assumption may not hold true for highly confident “lead” market participants, who, for reasons identified below, may assign an idiosyncratically large value to any anticipated reputational payoff so that deviation is the rationally preferred course of action.<sup>135</sup> Thus, the same incentive structure that accounts for the persistence of a non-cost-justified certification practice also anticipates that such a practice may ultimately disappear as lead market participants emerge with sufficiently high valuations of the reputational payoff from electing to deviate. If any of these market leaders deviates and then realizes its anticipated reputational gain (which implies that the market views the deviation as successful), it may progressively eliminate a non-cost-justified certification practice by reducing the expected reputational penalties incurred by other market participants that subsequently elect to deviate, thereby establishing a new standard that is then imitated by all “follower” participants pursuant to the same reputation-driven incentives that supported the previous (and now-lapsed) convention.<sup>136</sup> To illustrate this self-

---

<sup>135</sup> This claim is consistent with subsequent refinements of the reputational herding model initially developed by Scharfstein and Stein, as described above, *see supra* note \_\_\_. Specifically, Jeffrey Zwiebel argues that a manager’s susceptibility to herding behavior may be in part a function of the ability level of the relevant manager, such that average-ability agents will be most susceptible to hewing to the standard protocol while high-ability and low-ability agents will be least susceptible (the former having less risk of being misidentified as bad managers, the latter already categorized as low-ability and therefore willing to bet on a possibly successful innovation and a resulting reputational upgrade). *See* Jeffrey Zwiebel, *Corporate Conservatism, Herd Behavior and Relative Compensation*, 103 J. POL. ECON. 1 (1995).

<sup>136</sup> *See* Antonio Bernardo & Ivo Welch, *On the Evolution of Overconfidence and Entrepreneurs*, \_\_ J. ECON. & MGMT. STRATEGY \_\_ (1997) (arguing that overconfident entrepreneurs generate positive externalities by deviating from the herd and revealing private information contrary to a locked-in convention, thereby providing a mechanism for overcoming incorrect informational cascades); John C. Persons & Vincent A. Warther, *Boom and Bust Patterns in the Adoption of Financial Innovations*, 10 REV. FIN. STUD. 939 (1997) (arguing that pioneering innovations in financial markets are rapidly imitated by “waiting” firms when the relevant innovation generates observable positive returns, even if not as large as expected).



correction capacity, I identify three potential leaders in the legal market who appear at least to have the capacity to set new practice conventions: (i) elite and “upstart” law firms, (ii) collective organizations (most notably, the bar associations) and (iii) insurance carriers. This analysis (which is accompanied by evidence of modest historical contractions in closing opinion practice apparently initiated by some of these market leaders) is followed by a discussion of obstacles (mostly legal) that may prevent the emergence of these lead participants, thereby perpetuating value-depleting certification practices.

A. *Law Firms.* The law-firm market provides two possible candidates: (i) the relatively small group of elite national law firms and (ii) the new “upstart” firm that contests the older elite’s market share. Both market players are credited with developing new practices and contractual instruments that, where successful, are in turn adopted by the remaining mass of competing firms.<sup>137</sup> Elite firms may have incentives to deviate from convention to the extent they accrue reputational and other forms of capital (specifically, in the form of additional clients and higher billing rates) by successfully deviating from the conventional practices employed by other firms.<sup>138</sup> An elite law firm may also expect a lower reputational penalty for unsuccessfully deviating from convention to the extent that it has an established reputation as a high-ability

---

<sup>137</sup> See M.J. Powell, *Professional innovation: corporate lawyers and private lawmaking*, 18 L. & SOCIAL INQUIRY 423 (1986).

<sup>138</sup> It might be argued that this self-distinguishing incentive to accrue reputational capital by deviating from “mass-market” practices is neutralized to some extent by a countervailing incentive to preserve a large accumulated stock of reputational capital by conservatively hewing to market-accepted practices. The finance literature is in disagreement as to whether herding behavior is more or less likely to occur among market participants who have already accumulated significant reputational capital. Compare Scott Stickel, *Predicting individual analyst earnings forecasts*, 28 J. ACCOUNTING RESEARCH 409 (1990) (observing that the highest-ranked investment advisors tend to “follow the crowd” less than other advisors) with John R. Graham, *Herding among Investment Newsletters: Theory and Evidence*, 54 J. FIN. 237 (1999) (arguing that high-reputation investment newsletters have enhanced incentives to herd on the behavior of the market leader in order to protect their high status and pay) and Douglas W. Diamond, *Reputation Acquisition in Debt Markets*, 97 J. POL. ECON. 828 (1989) (arguing that more established borrower firms have incentives to select less risky projects since the cost of default increases as reputational capital accumulates and therefore, the payoff from a risky project declines relative to that of a safe project).

participant and consequently, the market does not automatically “demote” it based on a single unsuccessful departure from conventional practice.<sup>139</sup> A young firm lacks almost any reputational capital (other than reputational capital accumulated by founding partners from previous affiliations) and therefore has incentives to acquire such capital by offering a product that is recognizably different from its more established competitors. The new law firm cannot offer the reputational capital and prestigious brand name held by its more established competitors so it seeks to acquire market share by taking a position that is noticeably different from established convention, thereby demonstrating high confidence in its novel approach relative to the market standard.<sup>140</sup> In the closing opinion context, elite or upstart law firms may expect to accrue reputational capital by deviating from the opinion-requesting convention and, barring an adverse transactional outcome, thereby build a reputation as a business-friendly firm that “gets the deal done” efficiently. Lending some credence to this possibility, in the past decade or so the usage of closing opinions in certain settings appears to have contracted to a certain extent. Examples include: (i) the virtually complete withdrawal of closing opinions in the public mergers and acquisitions market; (ii) a possible slowdown in the use of closing opinions in the private acquisitions market<sup>141</sup>; and (iii) the reportedly increasing abandonment by

---

<sup>139</sup> See Owen Lamont, *Macroeconomic Forecasts and Microeconomics Forecasters*, J. ECON. BEHAV. & ORG. \_\_ (2002) (finding that an economic forecaster’s age negatively correlates with herding tendencies and attributing this result to the fact that as a forecaster ages evaluators develop “tighter priors” about his ability and hence the forecaster has reduced incentives to herd with the group).

<sup>140</sup> See generally C. Prendergast & L. Stole, *Impetuous Youngsters and Jaded Old-Timers: Acquiring a Reputation for Learning*, 104 J. POL. ECON. 1105 (1996) (providing a theoretical model where young or new market participants have enhanced incentives to take more extreme positions (even positions that the participant knows to be objectively unjustified), because younger participants wish to demonstrate having novel information relative to the accumulated pool of historical information represented by existing practices).

<sup>141</sup> See Schwartz, *supra* note \_\_, at \_\_ (stating that recently “some lawyers have relaxed traditional requirements for closing opinions in connection with mergers and acquisitions”).

California practitioners of requesting closing opinions in smaller acquisition and financing transactions.<sup>142</sup>

B. *Collective Organizations.* The second candidate in the closing-opinion market is the bar association, which, as a collective organization, may be uniquely situated to push the market toward a superior certification practice. Relative to any individual certification provider, a collective organization would appear to have the strongest incentives to implement an efficient modification in industry practice, because (1) to the extent it has the capacity to coordinate industry standards, it can rapidly neutralize any reputational penalty for deviations from a now-lapsed convention, and (2) as a collective organization, it largely internalizes the positive externalities generated by a value-enhancing innovation in industry practice (unlike a pioneering law firm that cannot internalize the benefits it confers on “bandwagon” firms who imitate its innovation). While bar associations may theoretically be an effective tool for facilitating abandonment of an obsolete industry standard, something approaching the opposite seems to have been the case historically in closing opinion practice, where the bar associations’ standardization efforts, while perhaps reducing the transaction costs of the closing opinion process, appear for the most part to have endorsed, and therefore simply further entrenched, existing certification practices.<sup>143</sup> As noted elsewhere, the California Bar (and, to a lesser extent,

---

<sup>142</sup> See 2004 CALIFORNIA BAR REPORT, *supra* note \_\_, in GLAZER ET AL., at App. 9A:38 n.4 (based on informal survey of California practitioners).

<sup>143</sup> The standardization efforts of the various bar associations, and the expansion of qualifying language in closing opinions, appear to have progressed simultaneously, with both phenomena commencing approximately in the early 1970s, roughly coinciding with several events that appear to have increased opining attorneys’ actual or perceived liability in issuing opinions: (1) the 1972 enforcement action by the SEC against prominent law firms involved in a fraudulent securities transaction (the “National Student Marketing Association” episode, *see supra* note \_\_), and possibly, (2) the increased use (or perceived increased use) of equitable and other discretionary powers by courts in overriding the literal terms of contractual agreements (3) the decline of the traditional business model in which a corporation retained a single law firm on a “retainer” basis, and (4) the erosion in most jurisdictions of the privity rule (which had previously protected lawyers from malpractice suits by non-clients). On the historical

some other regional bar associations) recently appears to have departed to a certain degree from these historical tendencies, specifically raising doubts as to whether it is cost-effective to require enforceability opinions in certain transactions.<sup>144</sup> The driving force behind these and other more discrete contractions in closing opinion practice<sup>145</sup> appears to be a creeping recognition by portions of the bar of the limited incremental value provided by a closing opinion and certain other legal opinions. As an illustration, in 1991, due to what it described as the dilutive force of standard qualifications that “swallow the bite” of the opinion, the ABA Committee on Legal Opinions recommended that legal opinions with respect to fraudulent conveyance issues should not “normally be requested”<sup>146</sup>, advice that the market is reported to have followed widely<sup>147</sup>, thereby illustrating the bar’s potentially potent coordinating power to correct inefficient industry practice.

C. *Insurance.* The third candidate is the insurance industry. It has a profit incentive to offer a superior bonding mechanism that either overcomes requesting agents’ rational disinclination to deviate from existing practice or prompts requested parties to seek to distinguish

---

escalation in the use of disclaimers and other qualifying language, see James J. Fuld, *Lawyers’ Standards and Responsibilities in Rendering Opinions*, 33 BUS. LAW. 1295, 1307 (1978); Deer, *supra* note \_\_; Dillon, *supra* note \_\_. See also Arthur Field & Steven Weise, *Remedies Opinions and Exceptions*, printed in AMERICAN BAR ASSOCIATION, NATIONAL INSTITUTE, THE SILVERADO SUMMIT: THE STANDARDIZATION OF LEGAL OPINIONS – ORDER OUT OF CHAOS (1989) (noting that “clean” remedies opinion did not contain until recently any limitation other than an exception for insolvency laws); Bradbury Clark, *supra* note \_\_ (same). On the erosion of the privity rule and other events in the early 1970s that increased opining firms’ perceived liability, see John Freeman, *Opinion Letters and Professionalism*, 1973 DUKE L. J. 371.

<sup>144</sup> See *supra* notes [34-37] and accompanying text.

<sup>145</sup> Another instance includes the recommendation by the 1998 TriBar Report to discontinue the practice of rendering foreign qualification and foreign good standing opinions because such opinions simply confirm that the opinion issuer has no reason to doubt the reliability of the government-issued certificates on which such opinions are based, see 1998 TRIBAR REPORT, *supra* note \_\_, at 647.

<sup>146</sup> See *ABA Guidelines*, *supra* note \_\_, at §I.C(i), cited in GLAZER ET AL., *supra* note \_\_, at §9.10.2

<sup>147</sup> See GLAZER ET AL., *supra* note \_\_, at §9.10.2.

themselves by offering a more potent bonding mechanism. The transformation of real estate transfer practices in the past several decades illustrates this phenomenon: the once-entrenched practice of issuing title opinions in real estate transactions in the United States has now been largely displaced by title insurance, which is a superior bonding mechanism insofar as title insurance companies probably have superior ability to identify title defects and clearly have superior financial ability to indemnify the buyer for title defects.<sup>148</sup> Assuming the potentially serious moral hazard difficulties could be overcome (and further assuming sufficient demand in light of other available bonding mechanisms), an insurance substitute could plausibly enter the closing opinion market. Illustrating this possibility, a California insurer has begun marketing to lenders a policy that covers losses based on failure of perfection or priority of a lender's security interests in borrower collateral<sup>149</sup>, which is presented as an alternative to the highly qualified perfection opinion typically issued by borrower's counsel.

D. *Obstacles to Self-Correction.* The extent of justifiable optimism as to the capacity of a degenerate certification market to correct itself should not be unduly exaggerated. The market leader may be slow in coming if it does not expect any net gains from migrating to a novel practice, which would arise either because the anticipated reputational penalties in the event of an erroneous deviation are sufficiently high or the anticipated reputational gains in the event of a successful deviation are sufficiently low. Two aggravating factors in particular can increase the costs of abandoning conventional practice. First, certain forms of cooperative action

---

<sup>148</sup> See Benito Arrunada, *A Transaction-Cost View of Title Insurance and its Role in Different Legal Systems*, published in *THE GENEVA PAPERS OF RISK & INSURANCE*, Vol. 27, No. 4, pp. 582-601 (Oct. 2002) [hereinafter Arrunada, *Title Insurance*]; Michael Braunstein, *Structural Change and Inter-Professional Competitive Advantage: An Example Drawn from Real Estate Conveyancing*, 62 *MO. L. REV.* 241 (1997).

<sup>149</sup> See *CLARK'S SECURED TRANSACTIONS MONTHLY* (2003); <http://www.eagle9.com/faq.html>.

among certification intermediaries can increase a market leader's anticipated costs of deviating from industry practice. As noted previously, the national and regional bar associations have made extensive efforts to standardize opinion language (and in particular, the qualifying language used in opinions). While these efforts may have reduced transaction costs by streamlining opinion negotiations, they have also effectively blessed and possibly "frozen" existing forms of closing opinion practice<sup>150</sup>, thereby increasing the anticipated reputational penalty for an unsuccessful deviation from industry practice. Second, legal requirements that require or strongly encourage use of a particular certification instrument can distort substantially the market's "natural" abandonment of an obsolete or otherwise non-cost-justified certification practice. There are a few minor examples that can be cited in the legal-opinion context (and, as discussed subsequently, major examples in the fairness opinion and credit ratings contexts<sup>151</sup>). In the financing context, "prudential" management requirements under certain banking regulations may support U.S. institutional lenders' policies that require delivery of a closing opinion from borrower's counsel in large financing transactions.<sup>152</sup> In the acquisition context, state corporate law in some jurisdictions (notably, Delaware) may distort opinion practice insofar as the fact of having obtained a closing opinion may be used as grounds for showing that the board took the requisite level of care in approving the relevant contested transaction.<sup>153</sup> These legal interventions may do little to improve the diligence investments of the relevant fiduciaries while entrenching non-cost-justified certification practices that may otherwise have contracted or disappeared. In turn, these legal entrenchments induce rent-seeking investments by interested

---

<sup>150</sup> See generally Coffee, *Comment, supra* note \_\_, at 62-63 (arguing that bar associations have made efforts to insulate opining attorneys from legal exposure by limiting issues as to which an opinion can be requested and limiting the agreed-upon scope of legal opinions).

<sup>151</sup> See *infra* Part V.A and B.

<sup>152</sup> See *California Remedies Opinion Report, supra* note \_\_, at 914 n.32.

<sup>153</sup> See *supra* note \_\_.

intermediaries that may prolong the usage of value-depleting certification instruments; thus, some intermediaries may lobby for the retention or introduction of legal requirements that block any future migration by market leaders to a more efficient certification alternative. Illustrating this danger, notary organizations in a variety of civil-law jurisdictions have repeatedly blocked simplification of business formation procedures<sup>154</sup> and, with the advent of title insurance, real-estate lawyers lobbied in some U.S. states for requiring the use of lawyers in real-estate transfers “to defend consumers’ interests”, apparently in response to the advent of competing title-insurance products.<sup>155</sup>

#### **V. Some More Puzzles: Applications and Extensions**

This Article’s analysis of the emergent opinion puzzle, and in particular, the incentive structure that may lie behind that puzzle, has been couched in generic terms to the maximum extent feasible so as to be applicable across a wide variety of transactional settings. The model of a degenerate certification practice, as sustained by agency-cost and adverse selection effects, has potential application as a diagnostic tool for identifying and accounting for the otherwise curious persistence of non-cost-justified certification instruments in the financial markets and other settings. While developed in the context of closing-opinion practice, this degenerate certification model yields a potentially broader insight: some markets may be afflicted not by the more commonly identified shortage, but rather an *excess*, of certification instruments, which, once entrenched (and then further entrenched by legal requirements), impose a cost of doing business that does little to alleviate informational asymmetries while being difficult to dislodge given the incentive structure and other factors described above. The resulting allocational

---

<sup>154</sup> THE WORLD BANK, DOING BUSINESS 2004, at 19-27 (2004).

<sup>155</sup> See Arrunada, *Title Insurance*, *supra* note \_\_\_\_.

distortion can be substantial. While an extraneous certification practice may generate relatively low costs on a “per-usage” basis, the social losses resulting from the inefficient persistence of any such practice may easily accelerate in the aggregate by force of multiplication across thousands of transactions annually.<sup>156</sup> Illustrating the potentially large social costs imposed by extraneous certification practices, the World Bank identifies the legally required use of notarial services (as in part sustained by strong lobbying efforts) as substantially inflating business formation costs in civil-law jurisdictions, thereby constraining entrepreneurial activity and economic development.<sup>157</sup>

Identifying a purportedly degenerate certification convention, especially where entry barriers in the certification market are low, market participants have roughly equal sophistication and distorting legal interventions are largely absent, is by definition fraught with uncertainty as it requires overriding the decision of a competitive market subject to pressures that would normally be expected to rapidly eliminate inefficient practices. As a general matter, however, any such market failure is not entirely surprising in light of the well-developed body of economic models that have always anticipated the theoretical possibility of socially excessive investments in signaling activities.<sup>158</sup> Consistent broadly with this more pessimistic (and complex) view of certification intermediaries, this Article’s thesis may potentially account for the surprising number of widely used but widely doubted certification products in the financial markets. These

---

<sup>156</sup> To see how quickly these costs can multiply, let’s make the artificially conservative assumption that there are approximately 1000 financing and acquisition transactions on average in the U.S. annually that are accompanied by a closing opinion and further assume a low-end average of \$5000 per opinion. This generates total annual expenditures of \$5,000,000 on closing opinions, all of which would represent a net social loss after deducting for any incremental informational value, not to mention the opportunity costs of any transactional delays due to the closing-opinion process and law firms’ fixed costs of maintaining an opinion “infrastructure”.

<sup>157</sup> Based on a database containing information on 130 jurisdictions, the World Bank reports that notarial requirements on average increase the time and cost of forming a business by, respectively, 15 days and an amount equal to 7% of per capita income. THE WORLD BANK, DOING BUSINESS 2004, at 19-27 (2004).

<sup>158</sup> For further discussion, see *supra* notes [14-15] and [125] and accompanying text.



additional “suspects” include: fairness opinions issued by investment banks; bond ratings issued by credit rating agencies; and potentially redundant forms of contractual boilerplate used in sophisticated deal documentation. As discussed further below, the net social value of these routine transactional practices is subject to ongoing dispute by academic researchers, market practitioners and, in some cases, regulators and judges. These doubts generally reflect some or all of the same factors that cast doubt on the certification value of closing opinions, including: (i) other information and/or diligence instruments already being available to transaction participants, (ii) limited or zero legal liability of the certification provider, (iii) conflicts of interest on the part of the certification provider and (iv) concentrated conditions in the certification market.

Given the potentially constrained informational value of these routine practices, there is some analytical curiosity as to why these practices widely persist in sophisticated business settings, although entry barriers and legal requirements (largely absent in the closing-opinion context) make it more difficult to pinpoint the principal source of any potential inefficiencies. To advance these intuitions somewhat further, I show below how this Article's two-sided incentive structure can, with minimal customization, account preliminarily for the potentially surprising persistence of fairness opinions, credit ratings and redundant contractual boilerplate. Given that some of these practices generate substantially greater costs than closing opinions (with fees extending into the millions of dollars in the case of a fairness opinion), and without taking a definitive position as to whether these costs likely exceed the incremental informational value typically yielded as a result these practices provide preliminary indications of both the ability of a degenerate certification practice to persist over a fairly broad range of cost conditions and the outside magnitude of any resulting social losses in the form of misallocated resources.

A. *Credit Ratings.* A credit rating purportedly provides new information concerning an issuer's financial condition to prospective buyers and existing holders of the issuer's debt securities, as provided by a trustworthy third-party intermediary with an established market reputation. Fees (which are paid by the issuer) are substantial and vary based on offering values, with the cap usually set at \$300,000.<sup>159</sup> The academic literature, market practitioners, agency regulators and congressional committees have widely observed that credit ratings have questionable *incremental* informational value in light of the fact that the rating agencies (i) are subject to limited legal liability in light of regulatory exemptions and court decisions granting First Amendment protections, (ii) rely on the accuracy of information provided by issuer management, (iii) have an overwhelming market share protected by certain regulatory barriers, (iv) are subject to a conflict of interest (given that the issuer funds the rating process), and (v) as empirical evidence shows (and as can be observed anecdotally by the rating agencies' famously tardy downgrades in the Enron implosion and slow reaction to the August 2007 turmoil in the mortgage-backed securities market<sup>160</sup>), despite the purported disciplining effect of reputational penalties, tend to follow, rather than lead, the market consensus.<sup>161</sup> In a telling observation, a Senate committee notes that 95% of corporate bonds are held by institutional investors who have in-house research departments to assess the value of bond securities, thereby casting doubt on the

---

<sup>159</sup> More specifically, rating agency fees range from 3 to 4 "basis points" (i.e., one-hundredths of a percentage point) of the face amount for the rated debt issue up to the cap stated above. See Frank Partnoy, *How and Why Credit Rating Agencies Are Not Like Other Gatekeepers*, in Fuchita & Litan, *supra* note \_\_\_, at 60 n.4 and 69.

<sup>160</sup> On the latter phenomenon, see James Kanter, *Europeans Plan to Investigate Ratings Agencies and Their Warnings*, N.Y. TIMES, Aug. 17, 2007.

<sup>161</sup> For congressional reports, see RATING THE RATERS: ENRON AND THE CREDIT RATING AGENCIES, HEARING BEFORE THE COMMITTEE ON GOVERNMENTAL AFFAIRS, U.S. SENATE, 107<sup>th</sup> CONG. 471 (Mar. 20, 2002) (statement of Prof. Jonathan R. Macey) (stating that credit ratings provide no useful information to the market); SEC REPORT ON THE ROLE AND FUNCTION OF CREDIT RATING AGENCIES IN THE OPERATION OF THE SECURITIES MARKETS, Jan. 2003, at p.4 [hereinafter, ROLE AND FUNCTION OF CREDIT RATING AGENCIES] (noting that, because credit rating agencies are subject to little regulation and liability is limited by regulatory exemptions and First Amendment protections, there is little penalty for poor performance). For the relevant empirical literature, see *supra* note [24] and accompanying text.

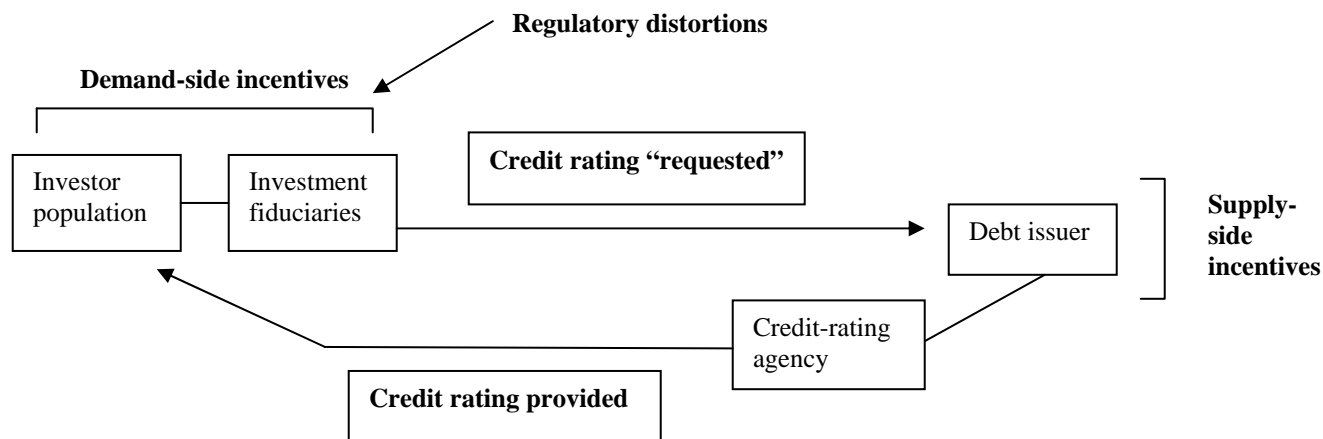
incremental value of credit ratings for most bondholders.<sup>162</sup> Taken together, the import of these findings is clear: credit ratings typically do not seem to tell the bond market (or most of the market) substantially (if anything) more than it knew already. The credit ratings market would therefore appear to have the “flavor” of a degenerate certification practice: widespread skepticism about its marginal informational value coupled with widespread usage in the relevant market.

A credit rating can be viewed as a certification instrument that is provided by an issuer (through the third-party rating agency) pursuant to the “constructive request” of the investor population (largely represented by agents in the form of money-managers and other investment fiduciaries). (Prior to the 1970s, this structure would have literally described the credit ratings process, which was then funded through subscriptions paid by institutional investors.<sup>163</sup>) Below I provide a graphical illustration of this proposed framework, which applies the two-sided incentive structure developed in the closing-opinion context while incorporating distorting external factors derived principally from applicable government regulation.

---

<sup>162</sup> See PRIVATE-SECTOR WATCHDOGS, *supra* note \_\_, at 78.

<sup>163</sup> See COFFEE, *supra* note \_\_, at 295-97.

**Figure III: Credit Ratings – Proposed Incentive Structure**

On the demand side, agency-cost pressures are strong insofar as a credit rating provides strong legal and reputational protection for the investment fiduciary—that is, the requesting agent—in the event it makes an “unsuccessful” investment choice.<sup>164</sup> As indicated in the Figure above, these demand-side incentives to conform to standard practice are then further exacerbated by several regulatory regimes mandating the use of credit ratings by fiduciaries and other actors for certain investment and regulatory purposes.<sup>165</sup> On the supply side, adverse selection pressures are powerful insofar as failure to deliver a strong credit rating is a formidable obstacle in widely marketing a debt offering transaction (and certainly results in a substantial pricing discount). Clearly a low credit rating catapults the issuer into the lower extremes of the issuer-quality spectrum, with potentially substantial pricing losses as a necessary result. Potentially illustrating this effect, it is reported that the Moody’s rating agency was once accused of obtaining some issuers’ business by issuing an unsolicited low rating, following which, given the actual or

<sup>164</sup> See COFFEE, *supra* note \_\_, at 287, 294.

<sup>165</sup> These regimes generally require the use of credit ratings provided by entities that have received the SEC’s “NRSRO” designation, which has currently only been assigned to a handful of firms. See PRIVATE-SECTOR WATCHDOGS, *supra* note \_\_, at 78-80; ROLE AND FUNCTION OF CREDIT RATING AGENCIES, *supra* note \_\_, at 6-10.

potential harm to the offering price, the issuer typically agreed to fund the agency's rating process and provide it with access to company information.<sup>166</sup>

B. *Fairness Opinions.* A fairness opinion is usually issued by a financial advisor (typically, an investment bank) to a target or, less commonly, an acquiror corporation in a merger or acquisition transaction, and provides the advisor's view as to the "fairness from a financial point of view" of the proposed deal consideration, based on valuation methodologies selected by the advisor in its discretion. A "fair" price for purposes of a fairness opinion is understood to mean not the highest price obtainable, but rather a price within the range that a reasonable and prudent board would accept in similar circumstances.<sup>167</sup> The advisor is usually the "deal advisor" to the corporation for the transaction generally, although in some cases additional third-party advisors are retained solely for the purpose of rendering an "independent" fairness opinion. In the typical scenario, the fees are bundled together with the financial advisor's "success fee" payable upon consummation of the transaction, with the opinion fee generally representing up to 10% of the sum of the total fees payable at closing (amounting to millions of dollars in any substantially sized transaction).<sup>168</sup> The academic literature<sup>169</sup>, the financial press<sup>170</sup>, some

---

<sup>166</sup> See COFFEE, *supra* note \_\_, at 294-96.

<sup>167</sup> See Bebchuk & Kahan, *supra* note \_\_, at 32.

<sup>168</sup> See Charles M. Elson, Arthur H. Rosenbloom & Drew G.L. Chapman, *Fairness Opinions—Can They Be Made Useful?*, 6 MERGERS & ACQUISITIONS LAW REPORT 907 (Dec. 1, 2003).

<sup>169</sup> See, e.g., Bebchuk & Kahan, *supra* note \_\_, at 29 (noting that "investment banks can arrive at widely differing estimates of 'fair price,' all of which would be reasonable and none of which could be shown to be 'wrong' (or unfair) under objective criteria").

<sup>170</sup> See, e.g., Ann Davis & Monica Langley, *Good Reviews: Opinions Labeling Deals 'Fair' Can Be Far From Independent*, WALL ST. J., DEC. 29, 2004, at p. A1; David Marcus, *Fair deal?*, THE DAILY DEAL, Feb. 18, 2005; NASD Notice to Members 04-83 (Nov. 2004).

judges<sup>171</sup> and regulators, and portions of the institutional-investor community<sup>172</sup> have observed that the informational value of fairness opinions is limited in light of the advisor's conflict of interest resulting from the contingent fee structure, the unavoidably subjective and uncertain valuation methodologies<sup>173</sup>, and the abundant use of disclaimers and qualifying language (which, as in the closing-opinion context, limits the reliant audience to the recipient board and disclaims independent verification of information supplied by the client<sup>174</sup>). As a result of these concerns, fairness opinions have received scrutiny from the New York State Attorney General's office, and subsequently the SEC, which has led to hesitant efforts since 2004 by the National Association of Securities Dealers ("NASD"), the self-regulatory body for brokerage firms, to propose certain new rules (principally, disclosure requirements).<sup>175</sup>

In the fairness-opinion context, we again seem to encounter the strong "flavor" of a degenerate certification practice: widespread skepticism as to the practice's informational value

---

<sup>171</sup> See Elson et al., *supra* note \_\_ (noting that courts "have harshly criticized investment banks and/or counsel for poorly crafted fairness opinions").

<sup>172</sup> See Ann Davis, *Wall Street's 'Fairness Opinions' Draw Fire from Calpers*, WALL ST. J., Feb. 8, 2005, at p. C1 (noting that largest US pension fund takes position that investment banks should be barred from delivering fairness opinions on acquisition transaction in which they act as the main adviser and that other large investors argue that NASD rules governing fairness opinions should be overhauled);

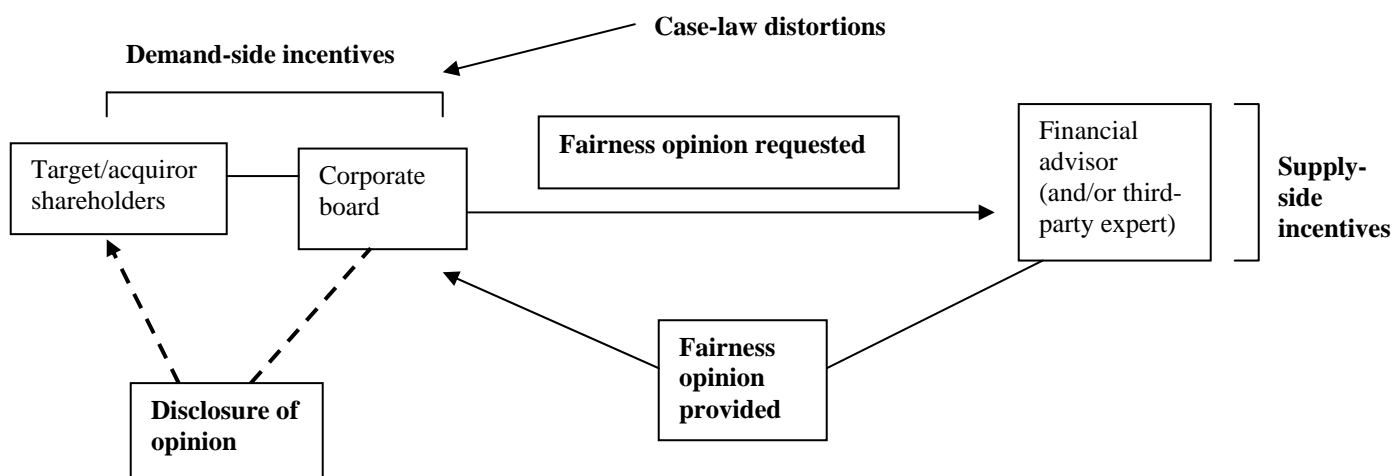
<sup>173</sup> See NASD Notice to Members 04-83 (noting that bankers are free to use a variety of valuation methods with the results sensitive to small changes in underlying assumptions). Other than the standard discounted cash flow ("DCF") analysis (which estimates the present value of the projected cash flows of a business), the investment banker has discretion to choose among a variety of other commonly employed methodologies to arrive at a fairness conclusion. Note that even the DCF analysis requires subjective judgment as to several potentially determinant variables, including the discount rate (the rate at which expected cash flows are discounted back to the present taking into account investment risk, opportunity cost of capital and expected returns, so that the higher the discount rate chosen, the lower the resulting valuation, and *vice versa*), adjustments to "EBITDA" (earnings before interest, taxes, depreciation and amortization), the EBITDA growth rates used to determine projected cash flows, and the terminal value.

<sup>174</sup> For an example of this disclaimer "in action", see *AOL Time Warner Inc. Securities and ERISA Litigation*, 381 F.Supp.2d 192, 244-245 (S.D.N.Y. 2004) (rejecting claims that investment bank was recklessly indifferent to the accuracy of the information on which its fairness opinion was based, on ground that investment bank disclosed that it was relying on information provided to it without independent verification of its accuracy or completeness).

<sup>175</sup> The proposed rules would require NASD member firms, among other things, to give greater disclosure of any possible conflicts of interest, including compensation arrangements. See NASD Proposed Rule Change to Establish New NASD Rule 2290 Regarding Fairness Opinions, SR-NASD-2005-080 (proposed June 22, 2005); Form 19b-4, filed by NASD with the SEC in June 2005 (available on [www.sec.gov](http://www.sec.gov)).

coupled with widespread usage amid largely stalled regulatory efforts to make some corrections. As the Figure below illustrates, the two-sided incentive structure that may sustain closing opinion practice can be applied with modest customization to construct a closely analogous incentive structure that accounts for the potentially curious persistence of fairness opinions.

**Figure IV: Fairness Opinions – Proposed Incentive Structure**



Within this structure, a fairness opinion operates as a certification instrument that is requested by the corporate board, the requesting agent acting on behalf of its principal, the shareholders of the target (or, less commonly, the acquiror) corporation. The “twist” in this case (which requires some modification as shown above<sup>176</sup>) is that the certification is requested from and provided by the financial advisor that has been retained by the requesting party, rather than by the counterparty in the relevant transaction. Interestingly, this implies that the fairness opinion

<sup>176</sup> As shown in Figure IV, the incentive structure is also modified to reflect the fact that the corporate board (i.e., the requesting agent) only delivers the certification instrument “in part” (hence, the dashed lines) to the firm shareholders (i.e., the requesting principal). In the standard case of a negotiated acquisition of a public company, the fairness opinion analysis is summarized in the proxy solicitation materials sent to target shareholders and the fairness opinion letter (but not the internal presentation containing the bank’s detailed financial analysis) is included as an exhibit.

constitutes a certification instrument that operates to ameliorate an informational asymmetry—essentially, concerning whether the proposed consideration is “at or above market”—between the corporate board and its agent, the investment bank, which has self-interested incentives to consummate the transaction in light of the “all or nothing” contingent fee structure (i.e., the bank receives no compensation if the transaction does not close). On the demand-side, the board may obtain a typically formulated fairness opinion even if it is highly uncertain as to whether doing so yields substantial incremental information, so long as *not* doing so is anticipated to trigger a sufficient reputational penalty in the event of an adverse transactional outcome. These demand-side incentives are enhanced substantially by Delaware case law holding that failure by a target board to obtain a fairness opinion can be evidence of failure to satisfy its duty of care.<sup>177</sup> On the supply side, adverse selection pressures easily drive the requested party (i.e., the investment bank) to comply with standard practice insofar as failure to provide a fairness opinion is a near-certain “deal breaker” in most acquisition transactions (again, due in part to the foregoing Delaware case law), which, as noted above, would typically result in a loss to the bank of virtually all fees payable in connection with the proposed transaction.

### **C. Contractual Boilerplate**

As any corporate lawyer knows, business people (and sometimes lawyers too) commonly lament the length of standard legal documentation used in sophisticated transactions, especially in U.S. legal practice, where business contracts are usually substantially longer than legal documentation used in other developed-country jurisdictions<sup>178</sup>, often casting doubt on whether some commonly included contractual clauses (often derided as mere “boilerplate”) are

---

<sup>177</sup> See *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985).

<sup>178</sup> See Thomas Lundmark, *Verbose Contracts*, 49 AM. J. COMP. L. 121 (2001).

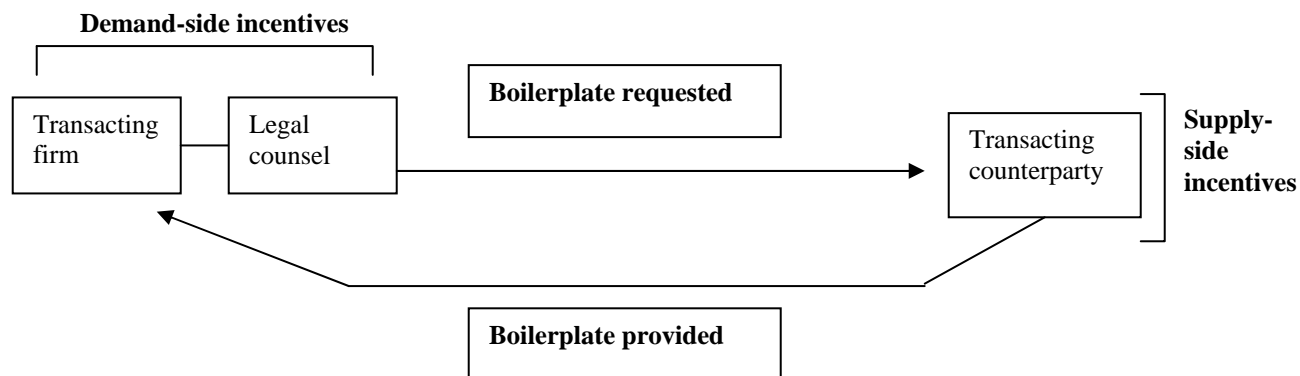


“absolutely necessary”.<sup>179</sup> In economic terms, these doubts (which recall the frustrations expressed by some legal and industry practitioners with respect to apparently “unnecessary” closing opinions) may be reformulated as uncertainty as to whether or not the contracting costs expended on some standard provisions generate at least commensurate benefits in the form of incremental assurance value. While the reasons for the potentially excessive length of sophisticated deal documentation remain unclear (in addition to whether any of this deal documentation is in fact non-cost-justified taking all relevant factors into account), the interaction between agency-cost and adverse-selection effects proposed in this Article may shed some light. As illustrated in the Figure below, “excessive” contractual boilerplate—let’s say, a representation that has minimal incremental assurance value in light of other contractual provisions and implied legal protections—can be viewed as a certification instrument that is requested in the course of business negotiations by an attorney acting on behalf of its principal, a transacting party; the requested certification is then agreed to by the counterparty’s attorney acting on behalf of the transacting counterparty.<sup>180</sup>

---

<sup>179</sup> There has recently been a flowering of scholarship on contractual boilerplate, to which this Section is merely a preliminary contribution. For a recent collection, see *Boilerplate: Foundations of Market Contracts Symposium*, 104 MICH. L. REV. 1033 (2006).

<sup>180</sup> Note that application of this structure to the boilerplate context requires modification to reflect the fact that the contractual certification is provided directly by the counterparty, as agreed to by counsel acting as its agent.

**Figure V: Contractual Boilerplate – Proposed Incentive Structure**

A simple example from corporate-law practice can illuminate this structure.

Sophisticated business agreements commonly include a clause whereby each party covenants to act in good faith in rendering performance of its contractual obligations. But it should be widely known among even not-so-sophisticated business attorneys that the duty of good faith generally is implied in every contract and, moreover, cannot even be expressly waived.<sup>181</sup> Thus, at most, reiterating the good-faith obligation is a legally redundant exercise that may have some highly speculative rhetorical value in any subsequent litigation; if that is the case, then the contracting resources devoted to negotiating and drafting this clause may well be a net loss. The two-sided incentive structure can account for the otherwise curious persistence of contractual redundancies. On the requesting side, reputational pressures drive the requesting attorney to conform to standard practice by insisting on inclusion of the “unnecessary” clause: hence, corporate lawyers’ frequent reference to “market standard” (rather than any “stand-alone” substantive rationale) in negotiating deal terms constitutes a rational strategy in light of anticipated exposure to reputational losses in the case of erroneous deviations (and, for reasons discussed above, minimal reputational gains in the case of a “successful” deviation). On the requested side, the

<sup>181</sup> See RESTATEMENT OF CONTRACTS (SECOND) § 205.

prospect of a disproportionate quality discount (to reflect the understandable risk of contracting with a counterparty who unusually refuses to represent that it will act in good faith) then drives the requested attorney almost always to accede to the request. The result: “excessively” lengthy contractual documentation persists because no participant (or at least, no individual agent) has any rational incentive to deviate unilaterally from an entrenched drafting convention, in each case independently of any individual participant’s uncertainty as to whether the relevant convention is cost-justified from a social point of view.

### **Conclusion**

Given the obvious importance of certification intermediaries to the efficient operation of the financial markets and the responsible design of appropriate regulatory interventions, our understanding of the circumstances under which certification intermediaries are or are not likely to remedy informational asymmetries at a net social gain is surprisingly still in its relative infancy.<sup>182</sup> Reflexive application of the certification thesis makes things simple: repeat-player intermediaries are presumptively an effective market-generated mechanism for resolving informational asymmetries that may otherwise frustrate or distort efficient transactions. But this easy presumption is *too* simple: it does not adequately describe an economically important category of certification practices that are widely used at positive resource cost but do not clearly appear to alleviate informational asymmetries. This apparent discrepancy raises a puzzle: why would non-cost-justified certification practices persist in a sophisticated market? This Article’s degenerate certification model provides a potential solution: reciprocal demand-side and supply-side incentives drive market participants rationally to request and deliver a minimally

---

<sup>182</sup> For similar views, see Riley, *supra* note \_\_; Jin et al., *supra* note \_\_.

informative certification instrument, even in the presence of widespread uncertainty as to whether doing so is always or usually cost-justified. This perverse outcome extends the growing taxonomy of “certification pathologies” assembled by legal scholars who have recently revisited the certification (or “reputational intermediary”) thesis, in the process identifying certain aggravating market-specific conditions (most notably, conflicts of interest, differential sophistication and market concentration) that may cause certification intermediaries to fail to screen out fraudulent and similar practices.<sup>183</sup> Importantly, the “pathological” outcome proposed in this Article does not rely on any of the conventionally mentioned aggravating conditions (in particular, it drops the assumption that certification recipients are unsophisticated) and, as a result, it potentially covers an additional range of sophisticated market settings where value-depleting certification practices might persist over a substantial period of time. Contrary to standard expectations, even routinely employed certification practices may convey little new information to contracting parties, thereby doing nothing more on a net social basis than impose a costly “drag” on market transactions.

---

<sup>183</sup> See *supra* notes [18-19] and accompanying text.

## APPENDIX

### Identified Federal and State Court Decisions (1986-2006) in Litigations Against Attorneys Involving “Closing Opinions” in Loan or Acquisition Transactions

---

- Mega Group, Inc. v. Pechenik & Curro, P.C., 32 A.D.3d 584 (N.Y.A.D. 3 Dept., 2006)
- Distinctive Home Builders, LLC v. Copar Const., LLC, 2006 WL 2556138 (Conn. Super. 2006)
- First Massachusetts Bank, N.A. v. Florian, 2005 WL 820536 (Mass. App. Ct. 2005)
- Connecticut Resources Recovery Authority v. Murtha Cullina, LLP, 2005 WL 3291920 (Conn. Super. 2005)
- Banco Popular North America v. Gandi, 876 A.2d 253 (N.J. 2005)
- Keybank Nat’l. Ass’n. v. Reidbord, 2005 WL 3184781 (W.D. Pa. 2005)
- Finova Capital Corp. v. Berger, 18 A.D.3d 256 (N.Y.A.D. 1 Dept., 2005)
- Dean Foods Co., et al. v. Pappathanasi, et al., No. 01-2595 BLS, 2004 WL 3019442 (Mass. Superior Ct., Dec. 3, 2004)
- National Bank of Canada v. Hale & Dorr, 17 Mass. L. Rptr. 681, 2004 WL 1049072 (Mass. Superior Ct., Apr. 28, 2004)
- Marcus v. Frome, 329 F.Supp. 2d 464 (S.D.N.Y. 2004)
- In re Precept Business Services, Inc., 2004 WL 2074169 (Bkrtcy. N.D. Tex. 2004)
- Reich Family LP v. McDermott, Will & Emery, No. 101921-03, 230 N.Y.L.J. 20, 20 col. 1 (N.Y. Sup. Ct., Oct. 29, 2003)
- Republic First Bank v. Abrahams, Lowenstein & Bushman, P.C., 2003 WL 23812027 (Pa. Com. Pl. 2003)
- Goldfine v. DeEsso, 309 A.D.2d 895 (N.Y.A.D. 2003)
- Zimmerman v. Dan Kamphausen Co., 971 P.2d 236 (Colo. App. 1998)
- Mark Twain Kansas City Bank v. Jackson, Brouillette, Pohl & Kirley, P.C., 912 S.W.2d 536 (Mo. App. W.D. 1995)
- Washington Elec. Co-op, Inc. v. Massachusetts Mun. Wholesale Elec. Co., 894 F.Supp. 777 (D.Vt. 1994)
- Resolution Trust Corp. v. Farmer, 836 F.Supp. 1123 (E.D. Pa. 1993)
- Scientific Leasing, Inc. v. Windle, 1993 WL 25336 (Tex. App.-Dallas, 1993)

Geaslen v. Berkson, Gorov & Levin, Ltd., 613 N.E.2d 702 (Ill. 1993)

Prudential Ins. Co. v. Dewey, Ballantine, Bushby, Palmer & Wood, 605 N.E.2d 318 (N.Y. App. 1992)

Cambridge Factors v. Sturges & Mathes, Not Reported in A.2d, 1992 WL 174744 (Conn. Super.), 7 Conn. L. Rptr. 110 (1992)

Stock West Corp. v. Taylor, 942 F.2d 655 (9<sup>th</sup> Cir. 1991)

Terremar, Inc. v. Ginsburg & Ginsburg, 1991 WL 57815 (Conn. Super. 1991)

Gibraltar Savings, State Federal Savings and Loan Association of Lubbock and Gateway Savings Bank v. Commonwealth Land Title Insurance Company v. Popham, Haik, Schnobrich, Kaufman & Doty, Ltd., 907 F.2d 844 (8<sup>th</sup> Cir. 1990)

United Bank of Kuwait PLC v. Enventure Energy Enhanced Oil Recovery Assoc., Inc., 755 F.Supp. 1195 (S.D.N.Y. 1989)

JST Properties v. First Nat'l Bank, 701 F.Supp. 1443 (D. Minn. 1988)

Crossland Savings FSB v. Rockwood Ins. Co., 692 F.Supp. 1510 (S.D.N.Y. 1988)

Crossland Savings FSB v. Rockwood Ins. Co., 700 F.Supp. 1274 (S.D.N.Y. 1988)

Vereins-Und Westbank v. Carter, 691 F.Supp. 704 (S.D.N.Y. 1988)

City Nat. Bank of Detroit v. Rodgers & Morgenstein, 399 N.W.2d 505 (Mich. App. 1986)