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# Opinion Letters for Bankruptcy Lawyers: What You Need to Know Before Issuing a Third-Party Opinion Letter


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# OPINION LETTERS FOR BANKRUPTCY LAWYERS: WHAT YOU NEED TO KNOW BEFORE ISSUING A THIRD-PARTY OPINION LETTER[1]

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## Panel Introduction

**I. Topic Introduction – Case Law Overview**

**II. Types of opinion letters**

**III. Why are opinion letters required**

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## WHAT IS A THIRD-PARTY OPINION LETTER AND WHY IS IT IMPORTANT?

### *What is a Third Party Opinion Letter?*

As succinctly described by the American Bar Association ("ABA") Committee on Legal Opinions:

> The Agreement for a business transaction will often condition a party's obligation to close on its receipt of a closing opinion covering specified legal matters from counsel for another party. When received, the closing opinion serves as a part of the recipient's diligence, providing the recipient with the opinion giver's professional judgment on legal issues concerning the opinion giver's client, the transaction, or both, that the recipient has determined to be important in connection with the transaction.

*Guidelines for the Preparation of Closing Opinions (including Legal Opinion Principles)*, 57 BUS. LAW. 875 (2002) ("*Guidelines for Preparation*").

### *What is a "reasoned" or "explained" opinion letter"?*

When an opinion "involves a difficult or uncertain question of professional judgment", a reasoned or explained opinion letter will also contain the opinion providers underlying rationale. ID. at 879. Given the lack of complete uniformity among courts and the fact that in many cases, the ultimate discretion in applying various doctrines rests in the bankruptcy court (or upper level courts as the case may be), opinion letters on bankruptcy matters will likely be "reasoned" opinions. *See Special Report on the Preparation of Substantive Consolidation Opinions Committee on Structured Finance and the Committee on Bankruptcy and Corporate Reorganization of The Association of the Bar of the City of New York*, 64 BUS. LAW. 411, 416-17 (2009).

Common examples of opinion letters that bankruptcy lawyers are called upon to author are the following:

- *Authority to File Opinions*. An authority to file opinion is a reasoned opinion that requires the opinion giver to opine on whether federal law or state governs what persons or entities have authority to file bankruptcy. Michelle P. Quinn and Brian M. Gottesman, *Third-Party Delaware Opinions for Structured Finance and Other Commercial Transactions*, Part III (May 20, 2013).[2]

- *True Sale Opinion*. A true sale opinion is a reasoned opinion in a structured finance transaction whereby the opinion giver opines whether the transfer of assets from a transferee to a borrower constitutes a true sale in the circumstance that transferee is placed into bankruptcy.

[2] *Available at* http://www.businesslawbasics.com/sites/default/files/files/Delaware%20Opinions%20Practice%20-%20Part%20III%20of%20III.pdf

- *Non-Consolidation Opinion*. An opinion required in structured finance transactions whereby the opinion giver will opine that a special purpose entity ("SPE") "will not be consolidated with other entities in the event of bankruptcy, thereby protecting the SPE's assets." Kelly Love, *A Primer on Opinion Letters: Explanations and Analysis*, 9 TENN. J. BUS. L. 67, 78 (2007).

- *Preference Opinion*. This type of opinion is a reasoned opinion whether a transfer could be avoided as a preferential transfer under 11 U.S.C. §§ 547 and 550.

***What is a "qualified" or "unqualified" opinion letter?***

A "qualified" opinion letter is "subject to exceptions that are not customary for opinions of the type involved." *Guidelines for Preparation*, 57 BUS. LAW. at 879.

***Why should Third-Party Opinions letters not be taken lightly?***

Law firms are often called upon by their clients to issue opinion letters. In determining whether a law firm should undertake a third party opinion it should balance a host of factors including its own expertise in the given area and the potential liability in issuing such an opinion. *See* Donald W. Glazer and Jonathan C. Lipson, *Courting the Suicide King*, 17 BUS. LAW TODAY 4 (2008). However, as identified in Donald Glazer's and Jonathan Lipson's article, quantifying this risk is difficult because:

- The absence of reliable statistics because of the paucity of reported judicial decisions involving third-party opinions;

- The lack of public information about settlements and defense costs (although [Mr. Glazer and Mr. Lipson] understand anecdotally that settlements can be in the high eight figures or even more);

- The inability to translate into dollar terms the impact a suit can have on a firm's practice and the productivity of the lawyers who worked on the challenged opinion; and

- Most importantly, the inability to place a value on the continuing existence of a law firm as an institution when a suit jeopardizes its future.

*Id*. However, as set forth in the following examples, the potential liability is real and to take it lightly could be potentially firm ending. *See id*.

In *In re Comvest Ltd., Inc.,* 2014 WL 7330486 (Bankr. N.D. W.V. 2014), a lease agreement led to a dispute involving the West Virginia Municipal League ("WVML") and the City of Fairmont ("City"). WVML sought leave to file a third-party complaint against Mr. Kevin V. Sansalone, the City attorney who issued an opinion letter regarding the lease agreement. "In the WVML's view, the Letter Opinion is erroneous and had Mr. Sansalone rendered a correct legal opinion, the City of Fairmont would not have executed the Lease-Purchase Agreement with

Comvest and no general damages would exist." *Id*. at *1. Fortunately, for Mr. Sansalone the Court found that "there is no plausible link between the Letter Opinion and Comvest's alleged misappropriation of funds and non-performance breach." *Id*. at *5.

In *In re National Century Financial Enter., Inc., Investment Litigation*, 2008 WL 1995216 (S.D. Ohio 2008), National Century's bankruptcy case led to various litigation. One of the investors, Pharos, alleged it was "fraudulently induced into making the investment and that one of the documents on which it relied was an opinion letter issued by National Century's outside legal counsel, Purcell & Scott." *Id*. at *1. Pharos alleged that Purcell & Scott issued opinions the firm knew was false. After a lengthy discussion, the Court found that the opinion letter was narrow in scope and "did not guarantee National Century's overall compliance with the law." *Id*. at *7. The Court went on to hold that Purcell & Scott could not be liable for negligent misrepresentation, aiding and abetting, conspiracy and violation of Ohio Blue Sky Law. In short, Purcell & Scott was faced with many claims due to issuance of an opinion letter. The firm was dismissed without liability but it could be assumed the litigation took a toll on the firm.

In *In re UC Funding I, LP, Trustee v. Berkowitz, Trager & Trager, LLC*, 2018 WL 2023485 (D. Conn. 2018), a law firm was sued for breach of contract, breach of the implied covenant of good faith and fair dealing, and negligent misrepresentation "based upon an opinion letter authored by Berkowitz that allegedly induced Plaintiffs to enter into a contract that eventually resulted in a loss of approximately $13,000,000" due to a bankruptcy. *Id*. at *1. The law firm was dismissed from the suit as the Court found that the opinion letter was not a contract, the law firm did not represent plaintiff and plaintiff did not sufficiently allege it was reasonable "to rely on the advice of Berkowitz, counsel for an adverse party in a financial transaction." *Id*. at *9. While the law firm was dismissed, plaintiff was given thirty days to amend its complaint, leaving the law firm still potentially on the hook for a $13,000,000 claim.

In *In re Enron Corporation Securities, Derivative & "ERISA" Litigation*, 2005 WL 2230167, a law firm was sued over an opinion letter involving true sale issues. The firm, Andrews & Kurth LLP, sought dismissal of the claims as the Court previously dismissed "functionally identical" claims against Kirkland & Ellis. *Id*. at *1. The Court dismissed the claims because plaintiff failed "to show with the required specificity [the opinion letters] were deceptive," failed to plead examples of public use of the opinion letters and failed to allege facts demonstrating the firm "directed or controlled Arthur Andersen and/or Enron in their use of" the opinion letters. *Id*. at *5.

In *In re Hillsborough Holdings Corp*, 118 B.R. 866 (Bankr. M.D. FL 1990), counsel for asbestos plaintiffs sought discovery from the author of an opinion letter. The attorney, from Latham & Watkins, issued an opinion letter to Deloitte regarding solvency in a leveraged buyout. While the opinion letter itself was not, at the time, cause for potential liability it was the subject of a discovery dispute. The Court denied a motion for protective order and required the attorney to provide information the attorney used to form his opinion that asbestos-related personal injury claims would not impact the solvency of a Celotex related entity. *Id*. at 871.

## BEST PRACTICES FOR OPINION COUNSEL[3]

1. **Identification**.

    a. Identify what opinions may be required for the transaction closing. This identification should be done as soon as possible, ideally on the deal kick-off call.

    b. Identify who will be drafting the opinion letters.

        i. Engage counsel early to prepare the opinion letter to avoid any last-minute delays. Keep in mind that counsel in different jurisdictions may need to be retained depending upon what is being requested.

        ii. Confirm that opinion counsel is qualified in the practice area or specialty covered by the opinion.

    c. As opinion counsel, make sure you understand the transaction and the lender's requirements for structuring the transaction. Opinion counsel should confirm the scope of its engagement in writing and obtain any necessary client consents.

    d. Working drafts of all transactional documents should be obtained and/or provided to opinion counsel.

    e. Identify any unusual aspects of the transaction that might deviate from market standard and impact the analysis required for the opinion, and discuss these with the firm's opinion committee or secondary reviewer.

    f. Identify what jurisdiction or what law will govern the transaction or the subject upon which the opinion is given.

    g. As opinion counsel, identify and understand who the recipient/beneficiary of your opinion letter is going to be. Is it limited to the lender, or is it also to be relied upon by a rating agency? Keep in mind, the more recipients or intended beneficiaries, the greater the potential liability.

2. **Form Opinions**. If possible, start with a form of opinion that has been widely-accepted by the rating agencies and sophisticated lender's counsel. However, ultimately opinion counsel is responsible for the contents, so do not blindly follow the form without independent research and diligence.

3. **Assumptions**. Avoid making non-standard assumptions in the opinion letter, as this may lead to extensive negotiations that may delay the transaction. Further, an opinion preparer should not make an assumption of a fact that it knows (or has reason to believe) is false.

[3] Many of these best practices are drawn from the ABA Core Opinion Practices and Principles

4. **Diligence**. Diligence should be geared to the type of opinion being given and should be highly organized.

    a. Diligence checklists, assigning responsible parties, should be created at the beginning of the engagement assigning responsible parties.

    b. Diligence and support for the opinion letters may also include certificates issued by borrower and other related parties. An opinion preparer, however, cannot rely upon factual assertions made by other parties that it knows to be inaccurate or has reason to believe is inaccurate.

    c. Arrange any follow up interviews to the extent necessary.

5. **Secondary Review**. The opinion preparer should have established some type of secondary review of the legal opinion. Depending upon size, a law firm may have an opinion letter committee or designated partners. The preparing lawyer should consult with the secondary review as early in the process as possible.

6. **Other Resources**. For other best practices, forms, and guidance see the following:

    a. Restatement (Third) of the Law Governing Lawyers[4]

    b. American Bar Association Legal Opinion Resource Center, which contains a comprehensive library of materials, *available at* https://www.americanbar.org/groups/business_law/migrated/tribar/.

        i. ABA Statement of Opinion Practices

        ii. ABA Core Opinion Principals

    c. Selected TriBar Opinion Committee Reports

        i. *Third-Party Closing Opinions: Limited Partnerships*, 73 BUS. LAW. 1107 (2018)

        ii. *Supplemental Report: Opinions on Chosen-Law Provisions Under the Restatement of Conflict of Laws*, 68 BUS. LAW. 1161 (2013)

        iii. *Supplemental TriBar LLC Opinion Report: Opinions on LLC Membership Interests*, 66 BUS. LAW. 1065 (2011)

[4] "[L]egal opinion practice is governed by three different sources: the Restatement (Third) of the Law Governing Lawyers ('Restatement'), the TriBar Reports (TriBar II, in particular), and the American Bar Association Legal Opinion Principles ('Principles')." Kelly Love, *A Primer on Opinion Letters: Explanations and Analysis*, 9 TENN J. BUS. L. 67, 70 (2007)(footnotes omitted)(explaining history of legal opinion governance and authority).

iv. *Third-Party Closing Opinions: Limited Liability Companies*, 61 BUS. LAW. 679 (2006)

v. *The Remedies Opinion – Deciding When to Include Exceptions and Assumptions*, 59 BUS. LAW. 1483 (2004)

vi. *UCC Security Interest Opinions – Revised Article 9 Report*, 58 BUS. LAW. 1449 (2003)

vii. *Third-Party "Closing" Opinions*, 53 BUS. LAW. 592 (1998)

d. *Special Report on the Preparation of Substantive Consolidation Opinions Committee on Structured Finance and the Committee on Bankruptcy and Corporate Reorganization of The Association of the Bar of the City of New York*, 64 BUS. LAW. 411 (2009).

e. *Legal Opinion Principles*, 53 BUS. LAW. 831 (1998)

f. *Ethics Issues in Opinion Practice*, 62 BUS. LAW. 417 (2007)

## STEPS IN THE NON-CONSOLIDATION OPINION LETTER CREATION PROCESS[5]

1. **What is Substantive Consolidation?**

    a. Substantive consolidation is a judicially-created doctrine based on bankruptcy courts' general equitable powers pursuant to Section 105(a) of the Bankruptcy Code. It is the power of the bankruptcy court to consolidate the assets and liabilities of affiliated entities in bankruptcy.

    b. There is no bright-line test, and the circuits have generated varying criteria for imposing consolidation. *See, e.g., Union Savings Bank v. Augie/Restivo Baking Co. Ltd. (In re Augie/Restivo Baking Co., Ltd.)*, 860 F.2d 270, 276 (D.C. Cir. 1987); *In re Owens Corning*, 419 F.3d 195, 211 (3rd Cir. 2005); *Drabkin v. Midland-Ross Corp. (In re Auto-Train Corp., Inc.)*, 810 F.2d. 270, 276 (D.C. Cir. 1987).

    c. A court may order substantive consolidation where, prior to bankruptcy, two or more entities acted like a single entity and should, therefore, be treated as a single debtor in bankruptcy. Courts consider factors showing entanglement or lack thereof, such as:

        i. The structure of the entities subject to substantive consolidation;

        ii. The relationships and dealings between the entities; and

        iii. The impact of substantive consolidation on creditors.

2. **Determine if an opinion letter is truly necessary.**

    a. If the lender is not going to securitize the loan in the commercial mortgage backed securities ("CMBS") market, a non-consolidation opinion may not be needed.

    b. If the loan is intended to be securitized, rating agencies' will only require a non-consolidation opinion for exceeding certain dollar amounts.

    c. If the entities in the borrower's chain of control are SPEs or the non-SPE owners do not own 49% or more of an SPE, an opinion may not be required.

3. **Contact the Opinion Preparing Counsel Immediately.** Borrower's counsel will want to identify and contact counsel who will be preparing the opinion as soon as it is known that such an opinion will be required. There is generally substantial diligence and the underlying transaction documents are generally very involved. As such, this type of opinion must begin at the start of the transaction, not the end.

4. **Determine if the lender has any specific structural requirements for the borrower and confirm that the borrower's proposed structure is acceptable.**

    a. Determine what "pairings" will be required.

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[5] For in depth analysis and guidance on Non-Consolidation Opinions including a sample form, *see Special Report on the Preparation of Substantive Consolidation Opinions Committee on Structured Finance and the Committee on Bankruptcy and Corporate Reorganization of The Association of the Bar of the City of New York*, 64 BUS. LAW. 411 (2009). Many of the procedures and steps identified herein are drawn from the *Special Report*.

b. Choice of law

c. Confirm that the structure of the borrower is proper for the transaction based on the applicable state's law, and will meet the requirements of the lender and rating agencies (*e.g.* If the borrower is to be an LLC, must it be organized under Delaware law? Will a springing member be required?).

d. If a non-corporate entity, *i.e.*, LLC or LP is being used, additional analysis may be required in the opinion letter as to the applicability of substantive consolidation doctrine on such entities.

e. Guaranties by affiliates. If guaranties exist, it may require additional analysis and explanation in the opinion letter.

f. Identify who the intended beneficiaries of the letter, *i.e.*, only lender or rating agencies.

**5. Review all transactional and organizational documents.**

a. Drafts of all loan transaction documents should be provided to counsel as soon as possible and as they are being prepared and revised.

i. Opinion counsel should not simply rely on the borrower and its transactional counsel to review the loan documents.

ii. The dual review process provides an extra measure of comfort to the lender that the transaction is properly structured to mitigate the risk of substantive consolidation.

b. Review the organizational documents for all entities in the borrower's chain of control.

i. Certificate of good standing from jurisdiction of organization

ii. Certified copies of the organizational documents filed with the secretary of state of the state of organization

iii. Articles of Organization or Incorporation

iv. Operating agreement and/or Bylaws

**6. Review the separateness covenants and independent director/springing member covenants in the loan agreement to ensure consistency with the organizational documents.**

a. If SPE is newly-formed, separateness /independent director covenants in the loan agreement will be negotiated and can be dropped into the operating agreement.

b. The non-consolidation analysis will rely heavily on the assumption that the separateness covenants will be complied with. Any inconsistency could undermine their effectiveness and weaken the validity of the analysis in the opinion.

c. Determine if a recycled entity is permitted, and if the conditions for such use can be met.

   i. Find out as soon as possible what representations of prior conduct the lender with require, and if those representations can be made

   ii. Opinion counsel should rely on a certificate of fact given by the member of the pre-existing SPE as to its prior conduct. The certification should affirm that at all times prior to the new loan transaction the borrower has operated consistent with the separateness covenants in the loan agreement.

   iii. Opinion counsel should independently review recycled SPE's prior organizational documents, public records searches (UCC, federal and state tax liens, litigation and judgments) and reports to confirm that the recycled entity certification is accurate.

   iv. Opinion counsel must also determine whether the company's prior contracts or course of dealings with affiliates will impair its ability to establish legal separateness.

d. If dealing with a refinancing situation, request and review any previous issued opinion letters.

7. **Prepare necessary factual certificates, conduct relevant interviews, and/or conduct such other diligence as may be necessary under the facts.** The opinion preparer will want to identify and create a checklist of the necessary diligence that will be required. This will make the process much more efficient and not allow any key issue to slip through the cracks.

8. **Update and Survey Law on Substantive Consolidation.** While many Non-Consolidation Opinion letters rely on similar case law, counsel should not blindly rely upon the case law used in a previous form. The case law should be checked to confirm it is still good law and opinion counsel should be apprised of any new developments in the law that may impact the opinion.

9. **Secondary Review.** Opinion counsel should comply with its internal firm's practices and procedures related to opinion letters. Given the uniqueness of bankruptcy issues, the preparing lawyer should identify and contact any secondary reviewer of the letter in order to allow such lawyer to get up to speed. Preparing lawyers should keep the reviewing lawyers apprised of any changes in the transaction and should take necessary and appropriate steps regarding any last minutes changes.

## SELECTED CASE SUMMARIES RELATED TO BANKRUPTCY REMOTENESS[6]

Courts have long held that restrictions on an individual's right to file bankruptcy should be rejected for public policy reasons. *See, e.g.*, *Bank of China v. Huang (In re Huang)*, 275 F.3d 1173, 1177 (9th Cir. 2002) ("This prohibition of prepetition waiver has to be the law; otherwise, astute creditors would routinely require their debtors to waive."). Several courts have expanded this restriction to corporate entities:

> The federal public policy to be guarded here is to assure access to the right of a person, including a business entity, to seek federal bankruptcy relief as authorized by the Constitution and enacted by Congress. It is beyond cavil that a state cannot deny to an individual such a right. I agree with those courts that hold the same applies to a "corporate" or business entity, in this case an LLC.

*In re Intervention Energy Holdings, LLC*, 553 B.R. 258, 264 (Bankr. D. Del. 2016)(footnotes omitted)(citing *Lake Michigan Beach Pottawattamie Resort*, 547 B.R. 899, 912 (Bankr. N.D. Ill. 2016); *In re Bay Club Partners–472, LLC*, 2014 WL 1796688, at *4–5 (Bankr. D. Or. May 6, 2014); *In re Shady Grove Tech Ctr. Assocs. Ltd. P'ship*, 216 B.R. 386, 390 (Bankr. D. Md. 1998) *supplemented*, 227 B.R. 422 (Bankr. D .Md. 1998)). *See also In re Lexington Hospitality Group, LLC*, 577 B.R. 676, 684-86 (Bankr. E.D. Ken. 2017).

However, whether a company has the authority to file bankruptcy has generally been a matter left to state law. *See In re Squire Court Partners Ltd. P'ship*, 574 B.R. 701 (E.D. Ark. 2017). "The Supreme Court long ago instructed that if a court 'finds that those who purport to act on behalf of the corporation have not been granted authority by local law to institute the proceedings, it has no alternative but to dismiss the petition. It is not enough that those who seek to speak for the corporation may have the right to obtain that authority.'" *Id*. at 706 (quoting *Price v. Gurney*, 324 U.S. 100, 106 (1945)). Thus, a tension exists between two longstanding bankruptcy policies. *See* Eric L. Johnson and Mark G. Stingley, "Intervention Energy Holdings: Good Public Policy, or Unnecessary Intrusion into State Law?" XXXV ABI Journal 11, 20, 76-78, Nov. 2016.

In addressing the tension between the competing policies related to bankruptcy remote companies, courts have reached varying conclusions. While the following list is not exhaustive, the identified cases demonstrate the issues that courts grapple with when faced with various bankruptcy remote provisions.

### A. *In re Global Ship Systems, LLC*, 391 B.R. 193 (Bankr. S.D. Ga. 2007).

The debtor was a Georgia LLC. The bankruptcy court dismissed an involuntary case where the involuntary petition was a subterfuge for a voluntary petition that was otherwise prohibited. As part of its financing, the lender was given a Class B equity interest in the debtor. The debtor needed the consent of the Class B equity to file bankruptcy. This consent right survived even after the loan was paid. The bankruptcy court found that a waiver to file bankruptcy violates public

[6] These case summaries were first used in the ABI Talks Presentation at the 2018 ABI Central States Bankruptcy Workshop in the presentation by Eric L. Johnson titled *Remote Control: Is a Bankruptcy Remote Company Truly Possible?*

policy, but when a creditor is wearing two hats both as a lender and equity holder, it has the unquestioned right to prevent a bankruptcy filing.

### B. *In re General Growth Properties, Inc.*, 409 B.R. 43 (Bankr. S.D. N.Y. 2009).

General Growth Properties, Inc. ("GGP") was a real estate investment trust and was the parent of approximately 750 wholly owned subsidiaries and affiliates. GGP had an elaborate and complex corporate structure holding many of its real estate projects in SPEs. The SPEs' documentation generally contained various restrictions, separateness covenants, and required the appointment of one or more independent directors or managers. As part of the 2008 financial crisis, the debtors had to begin contemplating Chapter 11 restructuring as several of its loans were going into default.

Several lenders filed motions to dismiss the bankruptcy case asserting that several of the SPEs' cases were filed in bad faith. The bankruptcy court denied the motions to dismiss finding, in part:

> However, if Movants believed that an "independent" manager can serve on a board solely for the purpose of voting "no" to a bankruptcy filing because of the desires of a secured creditor, they were mistaken. As the Delaware cases stress, directors and managers owe their duties to the corporation and, ordinarily, to the shareholders. Seen from the perspective of the Group, the filings were unquestionably not premature.

*Gen. Growth*, 409 B.R. at 64-65.

### C. *DB Capital Holdings, LLC*, 463 B.R. 142 (table), 2010 WL 4925811 (10th Cir. BAP, Dec. 6, 2010).

The debtor was a Colorado manager-managed LLC where the manager had no ownership in the debtor. The manager could only manage the debtor's ordinary course affairs. The debtor's operating agreement was amended to include a complete bar from filing bankruptcy. The debtor fell on hard times and the manager filed Chapter 11 bankruptcy. One of the members filed a motion to dismiss arguing that the manager lacked the requisite authority. The bankruptcy court dismissed case and manager appealed.

The Tenth Circuit Bankruptcy Appellate Panel ("BAP") affirmed the bankruptcy court. The BAP could find no law that would prohibit members from agreeing amongst themselves restricting the LLC's ability to file bankruptcy. The BAP found no evidence that the debtor's lender coerced the provision. Further, the BAP refused to opine on the result if the lender did coerce a provision. The BAP found that the dismissal was warranted because filing bankruptcy is outside the ordinary course affairs of the debtor and manager had no authority.

### D. *In re Bay Club Partners -472, LLC*, Case No. 14-30394, 2014 1796688, at *4-5 (Bankr. D. Or. May 6, 2014).

The debtor was an Oregon LLC. In connection with its financing, the debtor's operating agreement contained various special purpose entity provisions including an absolute prohibition on the filing of bankruptcy unless the financing was paid in full. The debtor filed for Chapter 11

bankruptcy. The lender filed a motion to dismiss asserting that the filing was not authorized. Without going into Oregon state law, the bankruptcy court found that the prohibition violated federal public policy.

**E. *In re Lake Michigan Beach Pottawattamie Resort LLC*, 547 B.R. 899 (Bankr. D. Ill. 2016).**

The debtor was a Michigan LLC. The debtor defaulted on loan obligations and entered into a forbearance agreement with its lender. The debtor was required to amend its operating agreement to establish that lender would become "special member". The special member would have right to approve or disapprove of any "material" action including filing bankruptcy. The special member had no rights in profits or losses and would not have any fiduciary duties to the debtor. The debtor filed bankruptcy without the special member's consent, and the lender sought to dismiss.

The motion to dismiss was denied on public policy grounds. First, the bankruptcy court recognized that absolute prohibitions against filing bankruptcy are considered "bad form." Second, the bankruptcy court found that the amendment was not a complete prohibition, rather it provided for a blocking director. However, the bankruptcy court found that the amendment to operating agreement was void under Michigan law because the special member was not required to consider the interests of the company.

**F. *In re Intervention Energy Holdings, LLC*, 553 B.R. 258 (Bankr. D. Del. 2016).**

The debtor was a Delaware LLC. The debtor defaulted on loan obligations and entered into a forbearance agreement with its lender. The debtor's operating agreement was amended to give lender one common unit for $1.00 capital contribution. The operating agreement was amended to require unanimous consent of all common unit holders in order to file bankruptcy.

The debtor filed for Chapter 11 bankruptcy. The lender's motion to dismiss was denied by bankruptcy court. The bankruptcy court found that the amendment to the operating agreement was determined to be void as against federal public policy:

> A provision in a limited liability company governance document obtained by contract, the sole purpose and effect of which is to place into the hands of a single, minority equity holder the ultimate authority to eviscerate the right of that entity to seek federal bankruptcy relief, and the nature and substance of whose primary relationship with the debtor is that of creditor—not equity holder—and which owes no duty to anyone but itself in connection with an LLC's decision to seek federal bankruptcy relief, is tantamount to an absolute waiver of that right, and, even if arguably permitted by state law, is void as contrary to federal public policy. Under the undisputed facts before me, to characterize the Consent Provision here as anything but an absolute waiver by the LLC of its right to seek federal bankruptcy relief would directly contradict the unequivocal intention of [lender] to reserve for itself the decision of whether the LLC should seek federal bankruptcy relief. Federal courts have consistently refused to enforce waivers of federal bankruptcy rights. I now join them, and conclude that the Debtors possessed the necessary authority to commence their chapter 11 proceedings.

*Intervention Energy Holdings*, 553 B.R. at 264-65.

**G. *In re Tara Retail Group, LLC*, Case No. 17-bk-57, 2017 WL 1788428, at *2 (Bankr. N.D. WV May 4, 2017), *appeal dism'd* 2017 WL 283015 (N.D. WV June 30, 2017).**

The debtor was a Georgia LLC. The debtor could not file bankruptcy without the unanimous consent of its members. Also, while the loan was outstanding, the debtor was to be managed by a single purpose entity with no ownership in the debtor. Further, there was to be an independent director who serves either as a manager of the debtor or board member of the single purpose entity. The debtor was prohibited from filing bankruptcy without unanimous consent of its board of directors and managers, including the independent director.

The debtor ultimately filed Chapter 11 bankruptcy. On the eve of bankruptcy, the debtor reached out to the independent director seeking his consent. He stated that he needed at least a week to consider the filing. The debtor then removed the single purpose entity as a manager, appointed two new managers, and filed bankruptcy.

The lender sought to dismiss the bankruptcy case. The bankruptcy court denied the motion to dismiss on the basis that the independent director acquiesced to the bankruptcy filing under Georgia law, thereby ratifying the filing. It did not have to reach the question of whether such provisions were valid for public policy reasons.

**H. *In re Squire Court Partners Ltd. P'ship*, 574 B.R. 701 (E.D. Ark. 2017).**

The debtor was an Arkansas limited partnership with three partners. The general partner, tasked with managing the operations of the debtor, filed bankruptcy without the consent of the debtor's limited partners. The limited partners sought to dismiss the bankruptcy filing. The bankruptcy court dismissed the bankruptcy case finding lack of proper authority.

On appeal, the district court affirmed the bankruptcy court. It distinguished several of the golden share/blocking director cases because the owners of the debtor did not delegate the right to veto a bankruptcy to a creditor. Rather, the owners kept the right to decide whether a bankruptcy should be filed.

**I. *In re Lexington Hospitality Group*, LLC, 577 B.R. 676 (Bankr. E.D. Ky. 2017).**

The debtor was a Kentucky LLC, which was manager managed. At its formation, the debtor had a sole initial member. Its initial operating agreement the initial member was the manager (the "Company Manager"). The original operating agreement was silent on the company's ability to file bankruptcy. As part of receiving additional financing, the operating agreement was amended to admit a new member (a company owned and controlled by the lender) and that company was given a 30% share in the debtor. In addition to the lender's company, two other members were each given a 5% share in the debtor.

The amendments also required the additional of "independent manager", who must approve a filing of bankruptcy, but only if 75% of the members approve. The agreement requires

the independent member to consider the interests of the company and the creditors in making the decision. The agreement also purports to eliminate all fiduciary duties of the independent manager. The amended agreement also contains a provision that all members vote affirmatively for the plan.

As part of forbearance, additional interests were transferred to the lender's created company to hold the LLC interests bringing its ownership to 50% with provisions that would transfer an additional 1%. The Company Manager ultimately caused the debtor to file Chapter 11 bankruptcy without the independent director's approval or a membership vote. The lender filed a motion to dismiss relying upon the bankruptcy restrictions in the operating agreement.

The lender's motion to dismiss was denied by bankruptcy court. The bankruptcy court found that the amendments to the operating agreement were determined to be void as against federal public policy. Further, the court found that the independent director provisions were merely a pretense in light of the absolute blocking provisions that were included.

**J. *In re Franchise Services of North America, Inc.*, Case No. 1702316EE (Bankr. S.D. Miss. Dec. 18, 2017), *certified for direct appeal to the Fifth Circuit by In re Franchise Services of North America, Inc.*, Case No. 1702316EE, 2018 WL 485959 (Bankr. S.D. Miss. Jan. 17, 2018), *on appeal Franchise Services of North America, Inc. v. United States Trustee, et al.*, 891 F.3d 198 (5th Cir. 2018).**

The debtor was a Delaware corporation. The debtor's certificate of incorporation provided that it could not file for bankruptcy without the written consent or affirmative vote by a majority of both its preferred stock holders and common stock holders, each voting as a class. The debtor has only one preferred stock holder. The debtor filed for bankruptcy without obtaining shareholder approval.

The bankruptcy court dismissed the petition. After going through the recent cases on blocking directors and golden shares, the bankruptcy court dismissed the motion of the creditor asserting a golden share provision finding that it was void against public policy. However, the bankruptcy court upheld the preferred shareholder right since it was not a creditor (although it was a subsidiary of a creditor).

The bankruptcy court certified the following questions for direct appeal to the Fifth Circuit:

> 1. Is a provision, typically called a blocking provision or a golden share, which gives a party (whether a creditor or an equity holder) the ability to prevent a corporation from filing bankruptcy valid and enforceable or is the provision contrary to federal public policy?
>
> 2. If a party is both a creditor and an equity holder of the debtor and holds a blocking provision or a golden share, is the blocking provision or golden share valid and enforceable or is the provision contrary to federal public policy?
>
> 3. Under Delaware law, may a certificate of incorporation contain a blocking provision/golden share? If the answer to that question is yes, does Delaware law

> impose on the holder of the provision a fiduciary duty to exercise such provision in the best interests of the corporation?

*Franchise Services*, 891 F.3d at 204.

On February 8, 2018, the Fifth Circuit granted leave for an expedited direct appeal. *See Franchise Services of North America, Inc. v. United States Trustee, et al.*, No. 18-90006, Doc. 00514341142 (5th Cir. Feb. 8, 2018)(*per curiam*). On May 22, 2018, the Fifth Circuit issued a panel decision. *See Franchise Services of North America, Inc. v. United States Trustee, et al.*, 891 F.3d 198 (5th Cir. 2018).The Fifth Circuit held that "[f]ederal law does not prevent a bona fide shareholder from exercising its right to vote against a bankruptcy petition just because it is also an unsecured creditor." *Id*. at 202.

However, such a decision should not be read as a blessing of golden share provisions. Indeed, the Fifth Circuit, in order to avoid rendering an advisory opinion, specifically narrowed the certified questions to the following single question: Whether parties, under U.S. and Delaware law, can "amend a corporate charter to allow a non-fiduciary shareholder fully controlled by an unsecured creditor to prevent a voluntary bankruptcy petition." *Id*. at 206. The Court distinguished the blocking director/golden share cases and held:

> This is not an advisory opinion, and our holding is limited to the facts actually presented in this case. We hold simply that federal bankruptcy law does not prevent a bona fide equity holder from exercising its voting rights to prevent the corporation from filing a voluntary bankruptcy petition just because it also holds a debt owed by the corporation and owes no fiduciary duty to the corporation or its fellow shareholders. **A different result might be warranted if a creditor with no stake in the company held the right. So too might a different result be warranted if there were evidence that a creditor took an equity stake simply as a ruse to guarantee a debt. We leave those questions for another day**.

*See id.* at 209 (emphasis added).

# AMERICAN BANKRUPTCY INSTITUTE ANNUAL SPRING MEETING 2019

## OPINION LETTERS FOR BANKRUPTCY LAWYERS: WHAT YOU NEED TO KNOW BEFORE ISSUING A THIRD-PARTY OPINION LETTER

## The Panel

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## Panel Introduction

- Topic Introduction – Case Law Overview
- Types of Opinion Letters
- Why are Opinion Letters Required
- Opinion Letter Creation Process
- Practical Tips and Diligence

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## What is a Third-Party Opinion Letter and why is it important?

- What is a Third Party Opinion Letter?
- Why should Third-Party Opinion Letters not be taken lightly?

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## Types of Third-Party Opinion Letters

- What is a "reasoned" or "explained" opinion letter"?
- What is a "qualified" or "unqualified" opinion letter?



## Best Practices For Opinion Counsel

- Identification
- Form Opinions
- Assumptions
- Diligence
- Secondary Review

**MOST IMPORTANT: DON'T WAIT TO THE LAST MINUTE**

## Non-Consolidation Opinion Creation Process

- **What is Substantive Consolidation?**
- **Steps in the Non-Consolidation Opinion Letter Creation Process**
  1. Determine if an opinion letter is truly necessary.
  2. Contact the opinion preparing counsel immediately.
  3. Determine if the lender has any specific structural requirements for the borrower and confirm that the borrower's proposed structure is acceptable.
  4. Review all transactional and organizational documents.

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## Non-Consolidation Opinion Creation Process *(cont.)*

5. Review the separateness covenants and independent director/springing member covenants in the loan agreement to ensure consistency with the organizational documents.
6. Prepare necessary factual certificates, conduct relevant interviews, and/or conduct such other diligence as may be necessary under the facts.
7. Update and survey law on Substantive Consolidation.
8. Secondary Review

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# Authority to File Opinions

- **What is an Authority to File Opinion?**
- **Recent Case Law Impacting Bankruptcy Remoteness**
  - *In re Lake Michigan Beach Pottawattamie Resort LLC*, 547 B.R. 899 (Bankr. D. Ill. 2016)
  - *In re Intervention Energy Holdings, LLC*, 553 B.R. 258 (Bankr. D. Del. 2016)
  - *Franchise Services of North America, Inc. v. United States Trustee, et al.*, 891 F.3d 198 (5th Cir. 2018)

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# Opinion Letter Resources

- Restatement (Third) of the Law Governing Lawyers
- American Bar Association Legal Opinion Resource Center, *available at* https://www.americanbar.org/groups/business_law/migrated/tribar/
  - ABA Statement of Opinion Practices
  - ABA Core Opinion Principles
- *Special Report on the Preparation of Substantive Consolidation Opinions Committee on Structured Finance and the Committee on Bankruptcy and Corporate Reorganization of The Association of the Bar of the City of New York*, 64 BUS. LAW. 411 (2009)

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