Division of Corporation Finance Issues Legal Bulletin Regarding Legality and Tax Opinions in Registered Offerings

On October 14, 2011, the Securities and Exchange Commission's (the "Commission") Division of Corporation Finance (the "Division" or the "Staff") issued Staff Legal Bulletin No. 19 (the "Bulletin"), providing guidance on legality and tax opinions issued in connection with registered offerings of securities under the Securities Act of 1933, as amended (the "Securities Act").[1] Specifically, the Bulletin covers:

- the requirements for legality and tax opinions;
- the Division's interpretation and application of the required elements for these opinions; and
- the filing of consents to include these opinions in registration statements.

The Division recognizes that opinion guidance must consider the context of a specific transaction, and the Bulletin includes examples of what the Division considers acceptable opinion practice in certain circumstances.

I. Legality Opinions

A. Requirements for and Substance of Legality Opinions

Item 601(b)(5)(i) of Regulation S-K requires that all Securities Act filings include an opinion of counsel regarding the legality of the securities being offered and sold pursuant to the registration statement, which is generally filed as an exhibit before the registration statement becomes effective.[2] Such opinion may not be subject to qualifications, conditions or assumptions that the Staff finds unacceptable.

In general, legality opinions must state that the securities are (1) legally (or validly) issued, (2) fully paid, (3) non-assessable and (4) if debt securities, binding obligations of the registrant.[3] With foreign corporate registrants, foreign counsel, or U.S. counsel competent to opine on the applicable foreign law, legality opinions must address these items, as such terms are understood under U.S. law, although such counsel need not use those exact terms.[4] The requirements for non-corporate registrants are substantially similar.

1. "Legally Issued"

In the context of equity issuances by U.S. corporate registrants, the phrase "legally issued," is understood by the Staff to mean that (1) the registrant is validly existing under the laws of the jurisdiction in which it is incorporated, and the securities are duly authorized; (2) the actions required by applicable state corporation law to approve the issuance of the securities have been taken; and (3) the securities have been or will be issued in compliance with the requirements of that law, the registrant's certificate or articles of incorporation and bylaws, and the resolutions approving the issuance of those securities. For non-corporate registrants, the phrase "legally issued" has a similar meaning in that (1) the entity is "validly existing"[5] under the laws of the jurisdiction in

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1 *See* SEC Staff Legal Bulletin No. 19 (CF) (Oct. 14, 2011), available at http://www.sec.gov/interps/legal/cfslb19.htm.

2 In addition, Schedule A requires the "names and addresses of counsel who have passed on the legality of the issue" to be disclosed and paragraph 29 of Schedule A requires the filing of "a copy of the opinion or opinions of counsel in respect to the legality of the issue...." *See* Schedule A to the Securities Act.

3 Regulation S-K Item 601(b)(5)(i).

4 *See supra* note 1 and Paragraph 12 of Schedule B of the Securities Act.

5 The Staff recognizes that a limited liability company is "validly existing" if it has been duly formed and has not been

which it is organized, (2) all steps have been taken to create and issue the securities in compliance with (and any procedural requirements thereof have been satisfied) any applicable statute and the applicable governing documents of the registrant and (3) any conditions on issuance in the resolution or other action approving the issuance of securities have been complied with.[6]

When there is a registration of American depositary shares ("ADSs")[7], the Staff requires the filing of an opinion stating that the ADSs, when sold, will be legally issued and will entitle their holders to the rights set forth in the deposit agreement and the American depositary receipt.[8] In the event that the ADSs are registered for offer and sale in connection with a registration statement for the underlying deposited securities, there will be two legality opinions--one from the depositary's counsel with respect to the ADSs issued pursuant to Form F-6 and the other from the foreign issuer's counsel with respect to the deposited securities issued pursuant to the accompanying registration statement.[9]

In the context of securities that are contractual obligations issued pursuant to agreements, such as debt securities and guarantees, the legality opinion is required to state that the debt securities will be "binding obligations of the registrant."[10] Such opinion is considered to encompass the fact that the registrant is validly existing, with the power to create the obligation and has taken the required steps to authorize entering into the obligation. [11] If the registrant is organized in a jurisdiction outside of the primary counsel's area of expertise (presumably, primary counsel's opinion will refer to the law of the jurisdiction governing the agreement or instrument pursuant to which securities are issued), the registrant may engage local counsel to provide the opinion above, while primary counsel may assume the same. Both opinions must then be filed as exhibits to the registration statement. Except where primary counsel is expressly relying on local counsel's opinion, both primary and local counsel would be named in the registration statement as having prepared or certified an opinion for purposes of Item 509(b) of Regulation S-K and would be required to file consents pursuant to Securities Act Rule 436(a). [12] If primary counsel is relying on local counsel's opinion, local counsel's opinion would be filed as an exhibit, but local counsel's consent would not be needed and it would not be named in the registration statement as having prepared or certified an opinion for purposes of Item 509(b) of Regulation S-K. [13]

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terminated due to the passage of time or voluntary action to dissolve.

6 The Staff does not object to the "duly authorized" opinion that is sometimes given in legality opinions relating to interests in limited liability companies, limited partnerships or statutory trusts, even though it considers this opinion, as applied to non-corporate entities, to be covered by a "legally issued" opinion.

7 ADSs represent an ownership interest in a specified number of a foreign issuer's equity securities that have been deposited with a depositary.

8 Form F-6 is the form used to register a public offering of ADSs, regardless of whether the offer and sale of the underlying deposited securities are also being registered under the Securities Act. *See* Item 3(d) of Form F-6.

9 *See supra* note 1.

10 Regulation S-K Item 601(b)(5)(i). Similarly, in the context of a registration of options, warrants or rights to purchase securities, counsel must opine that such security is a binding obligation of the registrant under the law of the jurisdiction governing the option, warrants or rights agreement, as applicable. To the extent the registrant registers the offer and sale of securities underlying the options, warrants or rights, the legal opinion must also cover the legality of the underlying securities.

11 *See* TriBar Opinion Committee, "Special Report of the TriBar Opinion Committee: the Remedies Opinion-- Deciding when to Include Exceptions and Assumptions," 59 Bus. Law. 1483, n.22 (2004).

12 *See* Securities Act Rule 436(f).

13 In this situation, primary counsel's opinion must cover the law of the jurisdiction of organization and cannot assume valid existence, power to create the obligation, or due authorization. *See supra* note 1.

When a registrant registers the offer and sale of units comprised of two or more underlying securities (as opposed to units of limited partnership interests or units of beneficial interest in a trust), the legality opinion must cover the legality of each component, as well as the unit itself. The Division has traditionally asked for a "binding obligation" opinion with respect to the legality of the units, but to the extent counsel believes the units should be treated similarly to shares of capital stock under the applicable state law, the Division may permit such opinion.[14]

The Staff acknowledged that the "binding obligation" opinion may be difficult to give in the context of rights issued under a shareholder rights plan because the determination of whether the rights will be binding in any given situation will be subject to the fiduciary duties of the board of directors and will depend on the specific facts and circumstances. Since, as a matter of law the foregoing cannot be predicted, the Division does not object if:

- the opinion does not address the determination a court of competent jurisdiction may make regarding whether the board of directors would be required to redeem or terminate, or take other action with respect to, the rights at some future time based on the facts and circumstances existing at that time;
- board members are assumed to have acted in a manner consistent with their fiduciary duties as required under applicable law in adopting the rights agreement; and
- the opinion addresses the rights and the rights agreement in their entirety, and states it is not settled whether the invalidity of any particular provision of a rights agreement or of rights issued thereunder would result in invalidating such rights in their entirety.

2. "Fully Paid"

"Fully paid" is understood by the Staff to mean that the consideration received by the registrant satisfies, in both type and amount, the requirements of applicable state or foreign corporation law, the registrant's certificate or articles of incorporation and bylaws, the resolutions approving the issuance of the securities and any other applicable agreement. In the case of limited liability companies, limited partnerships or statutory trusts, the Staff recognizes that there is no equivalent in statutory law for being "fully paid." In this context, because the non-corporate equivalent to the "non-assessable" opinion that is required to be delivered covers full payment, the Staff does not require that a separate opinion be given with respect to whether equity securities are "fully paid." Further, the Staff does not object to counsel assuming that the registrant will receive the required consideration in light of the fact that the opinion must be filed before effectiveness.

3. "Non-Assessable"

The Staff understands the term "non-assessable" to mean that the security holder is not liable, solely because of its security holder status, for additional assessments or calls on the security by the registrant or its creditors. In the case of non-corporate registrants, the "non-assessable" opinion (which may use the term "non-assessable") should address that full consideration has been paid and that neither the registrant nor any of its creditors has the right to require the holders of the securities to pay it anything more solely because they own securities. [15]

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[14] *See supra* note 1.

[15] Many corporate statutes use the term "non-assessable" (e.g. Delaware General Corporation Law Section 152). The concept of "non-assessability" may not precisely comport with the legal framework underlying a non-corporate registrant, so the Staff intends the "functional equivalent" of the form of opinion required for shares of capital stock issued by corporations to apply to non-corporate registrants.

B. Opinion Issues in Specific Transactions

1. Shelf Offerings

The general rule in shelf offerings is to have counsel's unqualified legality opinion filed as an exhibit to the registration statement before it becomes effective, except in the case of delayed shelf offerings.[16] Because delayed offerings off the shelf specifically contemplate a delay between the date of effectiveness and any sale of securities, the legality opinion in the shelf registration statement at the time it becomes effective may include assumptions regarding the future issuance of securities that would generally not be acceptable in connection with a non-shelf offering.[17] Whenever a takedown occurs, an updated opinion must be filed as an exhibit, unless an unqualified opinion was filed at the time of effectiveness. Such updated opinion cannot include the assumptions mentioned above. The registrant can file the updated opinion either pursuant to Securities Act Rule 462(d), which provides for the immediate effectiveness of a post-effective amendment filed solely to add exhibits to a registration statement, or to the extent such filings are incorporated by reference into the relevant registration statement, under cover of Form 8-K or Form 6-K.

2. Medium - Term Note Programs

Medium-Term Note (MTN) programs, which enable registrants to offer debt securities on a continuous or episodic basis, are an example of transactions where the Staff accepts an alternative opinion practice. In these transactions, the registrant may (1) file a qualified opinion when the registration statement is filed and an updated unqualified opinion when the takedown occurs or (2) file an opinion that assumes that the securities to be offered and sold in the MTN program will be legally issued with the MTN prospectus supplement and subsequently provide counsel's unqualified opinion as to a specific takedown in the text of the pricing supplement itself. The latter approach avoids a separate filing of an unqualified opinion as an exhibit to the registration statement or on Form 8-K or Form 6-K. However, if this alternative is chosen, the Staff expects that counsel's forward-looking opinion will include a consent to its opinion being issued in connection with a future pricing supplement and to such counsel being named as providing that opinion.[18]

3. Acquisition Shelf Transactions

The Division noted that the signed legality opinion filed as an exhibit to an acquisition shelf registration statement may be subject to assumptions regarding the future sale of the registered securities in an acquisition. For example, counsel may assume that the number of shares to be offered and sold under the registration statement will not exceed the number of shares authorized in the registrant's certificate or articles of incorporation—an assumption that would not otherwise be acceptable for a non-shelf registrant. If a post-effective amendment must be filed and declared effective before sales are made, the Division expects an appropriately unqualified opinion to be filed as an exhibit to that post-effective amendment. If no post-effective

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[16] *See* Securities Act Rule 415(a)(1)(x).

[17] *See* supra note 1. Such assumptions may include, for example, that the number of shares to be offered and sold under the registration statement will not exceed the number of shares authorized in the registrant's certificate or articles of incorporation; that the board will have taken all actions, passed all resolutions, etc., necessary to authorize the issuance and sale of the securities; that the specific terms of the securities will have been determined in accordance with all board resolutions or other authorization requirements; and that all required state approvals will have been received (e.g., if the registrant is a state regulated utility).

[18] The Division considers counsel responsible under Section 11(a)(4) of the Securities Act for a specific opinion attributed to it in a pricing supplement, unless and until the registrant files a Form 8-K stating that counsel's consent has been withdrawn.

amendment is otherwise required to be filed, the opinion may be filed by post-effective amendment or on Form 8-K or Form 6-K, as applicable, to the extent such filings are incorporated by reference into the relevant registration statement.

4. Exchange Offers

In cases where a registrant is required under its state corporation law or applicable securities exchange listing requirement (or for foreign registrants, under the law of their applicable jurisdiction) to obtain shareholder approval prior to issuing securities in an exchange offer, the Staff does not object to the legality opinion being subject to the assumption that the required shareholder approval will be obtained. The Staff expects the registrant to file an appropriately unqualified opinion by post-effective amendment or on Form 8-K or Form 6-K, as applicable, to the extent such filings are incorporated by reference into the relevant registration statement, no later than the closing date of the exchange offer.[19]

5. Reincorporation Before Closing of Offering and Offerings Conditioned on Charter Amendments

A legality opinion should address the laws of a registrant's new jurisdiction of incorporation if the registrant seeks to reincorporate before closing an offering. The opinion can be subject to the assumptions that any required shareholder approval for reincorporation will be obtained and the necessary filings will be made in accordance with state law so that incorporation of the new corporation is effective. Similarly, such assumptions are acceptable when offerings are conditioned upon amendments to a registrant's certificate or articles of incorporation. The Staff does not object to the solicitation of proxies to seek shareholder approval of the amendment when the solicitation is done contemporaneously with the offering of securities that is the subject of the amendment sought. The form of the amendment should be filed with the registration statement[20] In both cases, the Staff expects the registrant to follow the same procedure of filing an unqualified opinion post-effectiveness (as well as providing appropriate conditions to issuance disclosure in the prospectus) as mentioned above.

C. Assumptions, Qualifications and Limitations on Reliance

The Staff considers certain assumptions inappropriate for counsel to include in its opinion as they are overly broad, "assume away" the relevant issue or they assume any of the material facts that are either readily available or underlie the basis of the opinion. Examples of inappropriate assumptions cited by the Staff include that the registrant: is legally incorporated, has sufficient authorized shares, is not in bankruptcy, or has taken all corporate actions necessary to authorize the issuance of the securities.

Examples of acceptable assumptions and qualifications that may be necessary or appropriate in certain opinions were also highlighted in the Bulletin. For instance, it may be appropriate to include a statement that the documents reviewed and relied upon in giving the opinion are true and correct copies of the original documents, the signatures on such documents are genuine, the representations of officers and employees are correct as to questions of fact and that the persons executing the documents examined by counsel have the legal capacity to execute such documents.

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[19] In this situation, the prospectus should disclose that shareholder approval is a condition to the issuance of shares in the exchange offer.

[20] Regulation S-K Item 601(b)(3)(i).

In addition to opining on the law of the state where counsel is admitted, the Division noted that it does not object to the view that counsel not admitted in a certain jurisdiction, such as Delaware, is generally deemed capable of opining on that jurisdiction's law.[21] An opinion is acceptable so long as it is not qualified as to jurisdiction; it cannot carve out the law of the relevant jurisdiction or indicate that counsel is not qualified to opine on that law.

Similarly, in cases where a legality opinion for shares of stock is limited to the "Delaware Corporation Law," the Staff expects counsel to understand that a reference to "Delaware Corporation Law" includes all applicable Delaware statutory provisions and reported judicial decisions interpreting these laws.[22] The Staff objects to any limitation on reliance in opinions, as purchasers of the securities in the offering are entitled to rely on the opinion. Therefore, opinions, including the tax opinions covered below, should not state that they are "solely" or "only" for the registrant or its board of directors or another counsel.

II. Tax Opinions

Regulation S-K requires opinions on tax matters for filings on Form S-11, filings to which the Securities Act Industry Guide 5 applies, roll-up transactions and other registered offerings where the tax consequences are material to an investor and a representation about the tax consequences is included in the filing.[23] This opinion can be provided by legal counsel, a certified accountant or a revenue ruling from the Internal Revenue Service.[24]

The Division provided examples of transactions that may involve material tax consequences, such as mergers or exchange transactions where the registrant represents that the transaction is tax free and other transactions that offer significant tax benefits or where tax consequences are so unusual or complex that investors would need to have the benefit of a tax opinion in order to make an informed investment decision.[25]

A tax opinion should express a conclusion for each material tax consequence and reference the applicable Internal Revenue Code provision, regulation or revenue ruling.[26] Such opinions may be in long or short form.[27] When the tax opinion is in "long-form" the full tax opinion is filed as an exhibit and is summarized in the prospectus. In a "short-form" opinion the tax disclosure in the prospectus serves as the tax opinion. If the registrant elects to use a short-form opinion, the registrant must file the opinion as Exhibit 8 stating that the disclosure in the tax consequences section of the prospectus is the opinion of the named counsel or accountant. Regardless of whether the opinion is in long or short form, if counsel is unable to state an opinion on any material tax consequence, it should so state with a clear explanation and any possible alternative or risks to the investors of that tax consequence.

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21 *See* 1998 TriBar Report, §5.3 at 638-39.

22 While the Staff does not require counsel to explicitly confirm its understanding of this principle in its opinion, the Staff objects to an explicit exclusion of considerations of such reported judicial decisions. *See* TriBar Opinion Committee, "Third-Party Closing Opinions: Limited Liability Companies," 61 Bus. Law. 679, 681-82 (2006).

23 Regulation S-K Item 601(b)(8).

24 An IRS revenue ruling may be substituted for a tax opinion only if it is a specific letter ruling addressed to the registrant and covers all of the material tax consequences of the proposed transaction. A general revenue ruling would not be sufficient.

25 *See supra* note 1. For example, such transactions may include debt offerings with unusual original issue discount issues, certain rights offerings, limited partnership offerings or certain offerings by foreign registrants.

26 See Item 12 to Industry Guide 5 for further guidance on tax opinions.

27 *See supra* note 23.

Tax opinions can be conditioned or qualified so long as the related registration statement disclosure is adequate.[28] Certain assumptions, however, are considered inappropriate. Tax consequences at issue and any legal conclusions underlying the opinion cannot be assumed. If there is a lack of authority or conflicting authority addressing the tax consequences at issue, counsel or an accountant may issue a "should" or "more likely than not" opinion to make clear there is some degree of uncertainty.

As stated in the Bulletin, generally registrants must file the tax opinion or IRS ruling before the registration statement is declared effective. An exception arises in the case of a merger transaction that will be treated as a tax-free reorganization. In this instance, the Staff does not object if a tax opinion is filed after effectiveness so long as (1) the merger agreement includes a non-waivable condition that the transaction will receive an opinion at closing of the merger stating the merger will be treated as a tax free reorganization, (2) the prospectus sets forth the substance of the opinion to be provided at closing and (3) the opinion is filed prior to closing as an exhibit in a post-effective amendment or, if applicable, on Form 8-K or Form 6-K that will be incorporated by reference. Frequently, in the context of a merger or similar transaction, both parties may reserve the right to waive the condition of receipt of a favorable tax opinion. Though Item 601(b)(8) of Regulation S-K does not provide an exception to the requirement that the tax opinion be filed before effectiveness, the Staff does not object to the waiver so long as there is a non-waivable opinion delivered at closing. If this condition is waived, the registrant must (1) file an executed opinion of counsel prior to effectiveness and (2) recirculate and resolicit if the condition is waived and the tax consequence is material.

III. Consents

Under Section 7 of the Securities Act, a written consent of "any person whose profession gives authority to a statement made by him, [who] is named as having prepared or certified any party of the registration statement," is required to be filed with the registration statement.[29] All counsel providing legal and tax opinions must consent to the prospectus discussion of such opinion, the reproduction of that opinion as an exhibit and to being named in the registration statement.[30] The Staff noted that counsel need not expressly admit in the consent that it is an expert within the meaning of Sections 7 and 11 of the Securities Act, but the Staff objects to counsel explicitly denying that is an expert.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212-701-3403 or cgilman@cahill.com; Jon Mark at 212-701-3100 or jmark@cahill.com; John Schuster at 212-701-3323 or jschuster@cahill.com; or Mary Holst at 212-701-3672 or mholst@cahill.com.

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[28] See *supra* note 23.

[29] Section 7(a) of the Securities Act.

[30] *See* Securities Act Rule 436. The one exception to this consent requirement is under Rule 436(f). Where primary counsel is expressly relying on the local counsel's opinion, the local counsel's opinion would be filed as an exhibit, but the local counsel's consent would not be needed and the local counsel would not be named in the registration statement as having prepared or certified an opinion for purposes of Item 509(b) of Regulation S-K.