

*The Limits of Lawyering: Legal Opinions in Structured Finance*¹

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Abstract: Significant controversy surrounds the issuance of legal opinions in structured finance transactions, particularly where accountants separately use these opinions, beyond their traditional primary use, for determining whether to characterize the transactions as debt. Reflecting at its core the unresolved boundaries between public and private in financial transactions, this controversy raises important issues of first impression: To what extent, for example, should lawyers be able to issue legal opinions that create negative externalities? Furthermore, what should differentiate the roles of lawyers and accountants in disclosing information to investors? Resolution of these issues not only helps to demystify the mystique, and untangle the morass, of legal-opinion giving but also affects the very viability of the securitization industry, which dominates American, and increasingly global, financing.

In a vital area of finance, lawyers increasingly are being criticized³ and sometimes threatened with liability⁴ for issuing traditionally-required legal opinion letters.⁵ Although their

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³ See, e.g., Susan P. Koniak, *When the Hurlyburly's Done: The Bar's Struggle with the SEC*, 103 COLUM. L. REV. 1236, 1242-43 (2003) (criticizing the Bar for issuing structured-finance opinions in transactions that later turned out to be accounting shams); Keith R. Fisher, *The Higher Calling: Regulation of Lawyers Post-Enron*, 37 U. MICH. J.L. REFORM 1017, 1094-95 (2004) (observing that “none of these [complex financial manipulations] could have been consummated without the assistance of sophisticated, elite law firms, which had to render legal opinions known as ‘true sale’ opinions and ‘nonconsolidation’ opinions”); Mike France, *What About the Lawyers?*, BUS. WK., Dec. 23, 2002, at 58 (“By writing those opinion letters, attorneys blessed several transactions now being attacked as deceptive”). Cf. Nathan Koppel, *Wearing Blinders*, 26 AM LAWYER 75 (July 2004) (suggesting, *id.* at 165-66, that, even beyond conspiracy claims, the lawyers in Dynegy Inc.’s “Project Alpha” structured transaction deserve blame for failure to properly account for Project Alpha as debt). Professor Deborah Rhode of Stanford Law School likewise argues that lawyers should be sensitive to the possibility that their opinions may be used for a “wrongful” result. *Id.* at 164. Professor George Cohen of University of Virginia Law School similarly contends that, whatever the accountant’s role, “it is the lawyers’ obligation to ask, “Is this fraudulent? Is this deal designed to mislead investors?” *Id.* at 166.

⁴ See, e.g., *In re Enron Corp. Securities, Derivative & ERISA Litigation*, 235 F.Supp. 2d 549 (S.D. Tex. 2002) (denying a law firm’s motion to dismiss complaint). Cf. Carrie Johnson, *Lawyers in the Limelight*,

primary use is to assure investors and rating agencies on bankruptcy issues,⁶ these so-called “true-sale” and “non-consolidation” opinions are often separately used by accountants for advising that structured-finance transactions⁷ should be characterized, in a company’s financial statements, as “off-balance-sheet financing” rather than debt.⁸ The former characterization allows a transaction to be accounted for as a sale of assets, not a borrowing—the rationale being that the assets are (as the opinions provide) legally sold by the company to a separate entity,⁹ and even bankruptcy of the company will not reverse that sale or allow a court to consolidate the assets of the company and that separate entity.¹⁰ Thus, the company engaging in the transaction does not have to show additional debt on its balance sheet.¹¹

SEC Helps Police Their Misconduct, WASH. POST, Nov. 20, 2004, at E01 (suggesting, among other things, that the Securities and Exchange Commission will more aggressively file civil charges against lawyers).

⁵ This article uses the terms “legal opinion letters,” “legal opinions,” and “opinions” interchangeably. For a discussion of the nature of legal opinions, *see infra* notes 47-73 and accompanying text.

⁶ *See infra* notes 24-26 and accompanying text.

⁷ *See infra* notes 11-12 and accompanying text (describing structured-finance transactions).

⁸ Generally accepted accounting principles, or “GAAP,” require these opinions for an accountant to certify a transaction as off-balance sheet. *See* Financial Accounting Standard No. 140 (FAS 140) and AU 9336 (regarding reliance on these opinions). In practice this can have the effect of substituting legal opinions for the need for accountants to exercise fully independent judgment (as was required in the past under Financial Accounting Standard No. 77) in determining whether financial assets have been sold. The resulting dual-information problem exacerbates, but is not the core reason for, the information failure this article ultimately identifies as most problematic. *See infra* notes 162-164 and accompanying text. Although the question of whether accountants *should* be permitted to rely on legal opinions in making accounting determinations is beyond this article’s scope, FASB recently raised the possibility of severing the accounting from the legal determination under FAS 140. *See* minutes of FASB’s Sept. 22, 2004 meeting (*available at* http://www.fasb.org/board_meeting_minutes/09-22-04_qspe.pdf). There also is precedent in the corporate disclosure area for attorneys and accountants to work together to reach a mutually acceptable agreement on the extent to which accountants can rely on legal opinions. *See* Financial Accounting Standard No. 5 (reflecting a 1975 treaty between the accounting and legal professions allowing auditors to use legal opinions to assess contingent liabilities arising from litigation). To the extent change comes, it is likely to come through a treaty approach or a change in GAAP because any attempt by attorneys, at least individually, to withhold accountant reliance on their structured-finance opinions would probably fail because of the collective-action problem that, under FAS 140, accountants still need, and therefore originators still require, such reliance; and thus an individual attorney or law firm that withholds such reliance will be fired or not re-hired.

⁹ This separate entity being one or more special-purpose vehicles, or SPVs, as described in the next paragraph.

¹⁰ The true-sale opinion provides that the assets should be treated as legally sold, under bankruptcy law, by the company to that separate entity; the non-consolidation opinion provides that even the company’s bankruptcy should not allow a court to consolidate the assets of the company and that separate entity. Opinions are needed because structured-finance transactions could be viewed as either sales or secured loans under bankruptcy law, depending on their facts. STEVEN L. SCHWARCZ, *STRUCTURED FINANCE, A GUIDE TO THE PRINCIPLES OF ASSET SECURITIZATION* § 4:1, at 4-3 (3d. ed. & supps. 2005) (hereinafter “STRUCTURED FINANCE”).

¹¹ This use of structured-finance transactions is sometimes seen as a form of “earnings management.” Claire A. Hill, *Why Financial Appearances Might Matter: An Explanation for “Dirty Pooling” and Some Other Types of Financial Cosmetic*, 22 DEL. J. CORP. L. 141, 160 (1997) (discussing off balance sheet financing as a type of earnings management).

Structured-finance transactions include securitization, project finance, and similar transactions in which companies originating financial assets, such as accounts receivable, loans, or lease rentals, utilize special-purpose vehicles (SPVs, sometimes referred to interchangeably as special-purpose entities or SPEs) to facilitate the transaction. In a typical securitization transaction, for example, the company (sometimes referred to as the “originator”) sells rights to payment from the financial assets to a wholly-owned SPV, which in turn transfers these rights to an independent SPV, which in turn issues securities to capital-market investors. The independent SPV uses the proceeds of the issuance to pay the first SPV for the financial assets, and the first SPV then uses those proceeds to pay the originator. The investors, who are repaid from collections of the financial assets, buy the securities based on their assessments of the value of the financial assets.¹²

Structured-finance transactions used to raise money off-balance-sheet are not inherently bad, and indeed can have important benefits, such as better allocating risk with assets.¹³ However, they also can mask liabilities that only first become evident when a company goes bankrupt. Say, for example, a company is able to characterize a transaction as a sale with contingent recourse,¹⁴ which otherwise (but less appropriately) would be viewed as balance-sheet debt.¹⁵ In a sale transaction, the contingent recourse only needs to be shown on the company’s balance sheet if the contingency is “probable.”¹⁶ Although diligent investors would learn of contingent liabilities by reading the footnotes to the balance sheet¹⁷—such liabilities must be disclosed in those footnotes if the contingency is merely “reasonably possible”¹⁸—investors often focus exclusively on the

¹² Steven L. Schwarcz, *The Inherent Irrationality of Judgment Proofing*, 52 STANFORD L. REV. 1, 6 (1999). For a more complete analysis of securitization, see Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 STAN. J. L., BUS. & FIN. 133 (1994); STRUCTURED FINANCE, *supra* note 10. For a discussion of other (including inappropriate) uses of SPVs, see Steven L. Schwarcz, *Enron and the Use and Abuse of Special Purpose Entities in Corporate Structures*, 70 U. CIN. L. REV. 1309 (2002).

¹³ *Enron and the Use and Abuse of Special Purpose Entities in Corporate Structures*, *supra* note 12, at 1315 (arguing, based on a pronouncement by the Financial Accounting Standards Board, that “transfer of risk is, and should be, central to the accounting determination”).

¹⁴ This is a sale where the SPV-buyer has recourse (e.g., under warranties) against the originator under mutually agreed-to circumstances, which may or may not arise. The existence of contingent recourse against the originator is not necessarily inconsistent with the observation, *supra* note 13, that transfer of risk is central to the accounting determination. In all structured-finance transactions, the originator (i.e., the company transferring financial assets to the SPV) retains, and on an arm’s length basis must retain, first-loss risk on those assets to compensate for the information asymmetry between those parties. *Enron and the Use and Abuse of Special Purpose Entities in Corporate Structures*, *supra* note 12, at 1316 n. 38.

¹⁵ See *supra* note 8 and accompanying text.

¹⁶ Financial Accounting Standards Board, Statement of Financial Accounting Standards No. 5: Accounting for Contingencies (Mar. 1975) (requiring balance-sheet disclosure only of “probable” contingent risks) (“FAS 5”).

¹⁷ See, e.g., Steven L. Schwarcz, *Securitization Post-Enron*, 25 CARDOZO L. REV. 1539, 1556 n. 87 (2004) (“Post-Enron, no reasonable investor can claim ignorance of financial statement footnotes; investors have been widely educated to carefully review those footnotes as part of their investment or credit decisions”).

¹⁸ FAS 5, *supra* note 16 (allowing only remote risks to remain undisclosed). Moreover, Financial Accounting Standards Board Interpretation No. 45 of Guarantor’s Accounting and Disclosure Requirements for Guarantees (2002) requires guarantors to at least recognize on their balance sheets a liability for the fair value of the guarantee-obligation. See also § 401(a) of the Public Company Accounting Reform and Investor Protection Act of 2002 (“Sarbanes-Oxley”) (Pub. L. No. 107-204, 116 Stat. 745 (2002), codified at scattered sections of 15 U.S.C.), attempting to maximize GAAP disclosure of contingent liabilities by

balance sheet itself without regard to risks disclosed in the footnotes.¹⁹ They therefore often fail to anticipate that, in a bankruptcy, contingent recourse may be asserted as a claim against the company.²⁰

Nonetheless, true-sale and non-consolidation opinions—the legal opinions most commonly associated with off-balance-sheet financing²¹—are frequently issued by most major law firms.²² These opinions (hereinafter, “structured-finance opinions”) address only bankruptcy-law issues, and make no accounting analysis.²³ Indeed, their primary as well as historical purpose

amending § 13 of the Securities Exchange Act of 1934 (15 U.S.C. § 78m) to add at the end thereof a new subsection (j) requiring the SEC to issue “final rules providing that each annual and quarterly financial report required to be filed with the Commission shall disclose all material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the issuer with unconsolidated entities or other persons, that may have a material current or future effect on financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenues or expenses.”

¹⁹ Cf. Anne Tergesen, *The Fine Print: How to Read Those Key Footnotes*, BUS. WK., Feb. 4, 2002, at 94, 94-95 (noting that investors “could have had a heads-up that all was not quite right at [Enron] long before the bad news broke in October. The source of this information? The footnotes companies are required to publish with their financial statements. . . . Footnotes do not make for easy reading, however, and the numbers are often difficult to decipher”).

²⁰ One commentator suggested that the problem of possible investor failure to anticipate contingent recourse could be remedied by disclosing structured-finance transactions, including any associated contingent recourse, more prominently than in footnotes—perhaps even as a separate accounting category. I disagree. That disclosure would remove the “filter” of an accountant making an informed assessment of the transaction and associated recourse, resulting in an information dump that would make it harder, not easier, for investors to make informed investment decisions. If just the existence of contingent recourse were prominently disclosed, investors would have insufficient information to assess the risk, often misleading investors into believing that the company is riskier than it really is. Neither approach is likely to achieve a fair presentation of the company’s financial condition. See, e.g., Steven L. Schwarcz, *Rethinking the Disclosure Paradigm in a World of Complexity*, 2004 U. ILLINOIS L. REV. 1, 16 (2004) (citations omitted):

One therefore might ask whether structured-transaction disclosure could be reduced, in at least certain cases, to easy-to-understand elements like contingent recourse against the originator. This has an apparent simplicity—assess the risk that an originator will become liable for any contingent liabilities, and then include those liabilities (or a risk-discounted portion thereof) in the originator’s financial statements. This approach, however, would suffer from at least the same problems that a similar approach suffers in derivatives disclosure: it is impossible *ex ante* to precisely assess the risks, whereas a worst-case disclosure overemphasizes unlikely risks while potentially ignoring risks that are more realistic. . . . There are therefore no shortcuts to remedying disclosure’s insufficiency.

Moreover, even if more prominent disclosure *were* a solution, my article is normative and does not purport to solve that problem *per se*. Rather, I use that problem only to illustrate the urgent need to better understand legal opinions.

²¹ See *supra* notes 7-8 and accompanying text.

²² E-mail from Edward M. De Sear, securitization & structured-finance partner at McKee Nelson LLP, to the author (Apr. 15, 2005).

²³ “True-sale” and “non-consolidation” are solely issues of bankruptcy law. STRUCTURED FINANCE, *supra* note 10, § 3:4 at 3-22 & § 4:1 at 4-2. Thus, the “consolidation” referred to in a non-consolidation opinion solely concerns whether an originator and the SPV with which it is transacting would be substantively consolidated, or regarded as a single legal entity under § 105 of the Bankruptcy Code, for purposes of allocating the priority of claims against assets. STRUCTURED FINANCE, *supra* note 10, §§ 3:4 & 4:1.

is to assure investors and rating agencies²⁴ that the structure of the SPV²⁵ transaction is “bankruptcy remote.”²⁶ Furthermore, these opinions typically are—and, for purposes of the following discussion, initially will be assumed to be (although I later relax this assumption²⁷)—technically correct as to the legal matters they purport to cover.²⁸

This article’s scenario also must be distinguished from cases where lawyers issue legal opinions intended to be used to facilitate accounting or bankruptcy fraud.²⁹ Although structured-finance opinions address bankruptcy-law issues, such opinions typically are given at a time when bankruptcy is perceived merely as a theoretical possibility, not as a likely risk.³⁰ Similarly, although structured-finance opinions are complex and require a great deal of sophistication on the part of counsel,³¹ there is nothing inherently deceptive or illegal about them or the structured-

Accounting consolidation, in contrast, solely concerns whether that SPV’s assets and liabilities should be included in the consolidated financial statements of the originator.

²⁴ Rating agencies are private companies that assess, or “rate,” the risks associated with the full and timely payment of debt securities. Steven L. Schwarcz, *Private Ordering of Public Markets: The Rating Agency Paradox*, 2002 U. ILLINOIS L. REV. 1, 2-3 (2002). Investors rely on the rating based on the rating agency’s reputation; presently, the highest-reputation rating agencies are Standard & Poor’s Ratings Services, Moody’s Investors Service, Inc., and Fitch Investors Service, Inc. *Id.* at 6-7. Because a high rating signals low credit risk to investors, a company that issues highly-rated securities can—other things being equal—more easily attract investors for its securities than can a company that issues lower-rated securities. Therefore the company with highly-rated securities can pay a lower interest rate on those securities, and still attract investors, than can the company with the lower-rated securities. *Id.* at 8.

²⁵ Defined *supra* note 7.

²⁶ See, e.g., Christopher Frost, *Asset Securitization and Corporate Risk Allocation*, 72 TUL. L. REV. 101, 122 (1997) (explaining that rating agencies typically require opinion letters from originator’s counsel “stating that the SPV likely will not be substantively consolidated with the originator and that the transaction will effectively remove the assets from originator’s bankruptcy estate”). For a discussion of “bankruptcy remoteness,” see STRUCTURED FINANCE, *supra* note 10, at 3-1.

²⁷ See *infra* notes 256-272 and accompanying text (relaxing the assumption that structured-finance opinions are technically correct).

²⁸ E-mail from Edward M. De Sear, *supra* note 22 (observing that he has “no reason to doubt the technical correctness of the true sale and non-consolidation opinions that are rendered by law firms that are nationally recognized in the area of structured finance”).

²⁹ Cf. John P. Freeman, *Opinion Letters and Professionalism*, 1973 DUKE L. J. 371, 421 (1973) (discussing a case in which the SEC alleged—and Freeman assumed as true for purposes of argument—that “the lawyers knew or should have known that [the company whose financial statements were being certified] intended to use the opinions to satisfy PMM [the accountants] that the sale of [a subsidiary and the parent company’s] gain therefrom could be accounted for in [the parent company’s] financial statements for the fiscal year ended August 31, 1969” even though negotiations for that sale had not even commenced when the opinions were given (and the opinions failed to disclose that negotiations had not commenced). Although that case is superficially similar to this article’s scenario in that “it is not the issuance of the [legal] opinions per se that [are] illegal” but, rather, the accounting purpose for which the opinions are ultimately used (*id.* at 424), that case is fundamentally different because this article’s scenario assumes that the lawyers neither know nor should know that their opinions will be used to facilitate an accounting fraud (although they know, or should know, that their opinions will be used to facilitate off-balance sheet accounting, presumably in accordance with GAAP).

³⁰ Schwarcz, *The Alchemy of Asset Securitization*, *supra* note 12, at 137.

³¹ See, e.g., SPECIAL REPORT BY THE TRIBAR OPINION COMMITTEE, OPINIONS IN THE BANKRUPTCY CONTEXT: RATING AGENCY, STRUCTURED FINANCING AND CHAPTER 11 TRANSACTIONS, 46 BUS. LAW. 717 (1990-1991) (stating, *id.* at 721, that these opinions are normally provided in “reasoned” form, signifying

finance transactions on which they opine.³² Nor is there any proof that lawyers, in rendering these opinions, have *mens rea* or intent to mislead the public.³³ Even though, as mentioned, off-balance-sheet financing sometimes may mask liabilities that only first become evident to some investors when a company goes bankrupt (and thus those investors in fact may be misled),³⁴ diligent investors would have learned of those liabilities by reading the footnotes to the company's financial statements.³⁵

Why, then, are lawyers being accused of wrongdoing merely for issuing these opinions?³⁶ And, in that context, what duties should a lawyer have to the public in rendering the opinions? These questions go to the essence of what it means for lawyers to issue legal opinions that create negative externalities (hereinafter, "externalities"³⁷)—such as by potentially misleading readers of financial statements issued by companies acting as originators,³⁸ and thus ultimately misleading

inherent "uncertainties and limitations to the recipient"); STRUCTURED FINANCE, *supra* note 10, § 4:1, at 4-5 (observing that the "cases [on true sale] are not easily harmonized, and different readers can argue as to which factors are relevant, and which are entitled to the greater weight"). A typical reasoned structured-finance opinion resembles, in the author's experience, a mini-treatise, comprising 40-60 single-spaced pages.

³² See *Securitization Post-Enron*, *supra* note 17, at 1551-74 (arguing that securitization, the dominant form of structured-finance transaction, is efficient, fair, and economically desirable). See also *Enron and the Use and Abuse of Special Purpose Entities in Corporate Structures*, *supra* note 12, at 1314-18 (distinguishing between legitimate and illegitimate uses of SPVs) and at 1315-17 (arguing that even transactions designed solely to achieve accounting results should not be presumptively unlawful).

³³ *But cf. In re Enron Corp. Securities, Derivative & ERISA Litigation*, *supra* note 4, at 704-05 (refusing to dismiss claims against law firm where complaint alleges, among other things, that law firm issued true-sale opinions necessary to effectuate client's allegedly fraudulent plan).

³⁴ See *supra* notes 14-19 and accompanying text.

³⁵ See *supra* notes 18-20 and accompanying text.

³⁶ These accusations arise, I will show, because structured-finance transactions can have potential information failures. I argue, however, that these failures are primarily the fault of investors, and at most are exacerbated by the dual-information problem—that legal-opinion information is accurately provided for one purpose, bankruptcy, but then used out of context for another purpose, accounting. Also, to some extent these accusations reflect the reality that when companies fail, lawyers are often the deepest pockets; and, because the criteria for a bankruptcy sale are not at all clear-cut, the existence of contingent recourse in the underlying transaction may prompt injured parties and regulators to assert that structured-finance opinions are wrong. To avoid the costs and vagaries of litigation, such cases are usually settled even where the opinions are accurate. These accusations also can result from imposition of retroactive laws.

³⁷ The infringement of rights of non-contracting parties is referred to as an "externality." See, e.g., Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1111 (1972). The economic definition of externalities means "the indirect effect of a consumption activity or a production activity on the consumption set of a consumer, the utility function of a consumer, or the production function of a producer." 2 THE NEW PALGRAVE: A DICTIONARY OF ECONOMICS 263, 263-65 (John Eatwell et al. eds., 1987). Legal commentators, however, usually define externalities as harm (or costs) to third parties. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1436-41 (1989); Richard A. Epstein, *Surrogacy: The Case for Full Contractual Enforcement*, 81 VA. L. REV. 2305, 2325-26 (1995); Richard A. Posner, *Blackmail, Privacy, and Freedom of Contract*, 141 U. PA. L. REV. 1817, 1818-19 (1993). Third parties theoretically may even include the public at large.

³⁸ Defined *supra* note 7.

investors in *those companies' securities*.³⁹ If there is a duty to the public as well as to the opinion recipient when lawyers issue legal opinions, is that duty the same, for example, as the duty of an internal government lawyer to the public when writing a legal opinion that advises on the legality of interrogation policies for enemy detainees?⁴⁰ And, in a broader sense, exactly what type of “speech” is a legal opinion? Remarkably, these are issues of virtually first impression.

These questions also force a rethinking of the ambiguous line between disclosure required by securities law and the accounting-disclosure implemented through issuance of certified financial statements. Although the latter originated as a financial-information subset of securities-law disclosure, explicitly delegated to the accounting profession by the Securities and Exchange Commission,⁴¹ the boundary of that subset has blurred in recent years.⁴² As a result, and as the legal-opinion controversy illustrates, there is uncertainty about the proper divide between the role of the lawyer and the role of the accountant in disclosing information to investors.

On a more practical level, the answers to these questions will dictate the very viability of the entire structured-finance industry. The economic consequences are enormous: securitization alone,⁴³ one of the “dominant means of capital formation in the United States”⁴⁴ and rapidly expanding worldwide,⁴⁵ has over six-trillion dollars of financing outstanding in the U.S. alone.⁴⁶

This article first discusses the nature of legal opinions. It then examines and assesses the criticisms of structured-finance opinions in the context of the historical debate over whether, and the extent to which, lawyers have a responsibility to the public in addition to their responsibility to clients. The article next analyzes, from a normative standpoint, what constraints should bind structured-finance opinions, and the lawyers providing them. Because the analysis is normative, its critique of legal-opinion practice in the United States may help inform the practice abroad.

³⁹ I emphasize the potential for misleading investors in the *originator's securities* because, in a typical structured-finance transaction, only those investors—and not the SPV's investors—potentially would be misled. See *supra* notes 14-20 and accompanying text.

⁴⁰ I refer, of course, to the now infamous August 1, 2002 memorandum from Assistant Attorney General Jay Bybee, prepared with the assistance of Deputy Assistant Attorney General John C. Yoo and others in the U.S. Department of Justice Office of Legal Counsel, to Alberto R. Gonzalez, Counsel to the President, advising on interrogation methods that supposedly would not violate prohibitions against torture.

⁴¹ See Steven L. Schwarcz, *Private Ordering*, 97 NW. U. L. REV. 319, 320, 346-47 (2002) (discussing the SEC's delegation of disclosure power to the accounting profession through the profession's privately-organized Financial Accounting Standards Board (FASB), resulting in GAAP).

⁴² See Steven L. Schwarcz, “Financial-Information Failure: Rethinking the Boundary Between Lawyer and Accountant Liability” 5-6 (June 29, 2005) (unpublished manuscript, on file with author).

⁴³ See *supra* note 7 (describing securitization).

⁴⁴ Investment Company Act, Release No. 19105, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,062, at 83,500 (Nov. 19, 1992) (provided in connection with the SEC's issuance of Rule 3a-7 under the Investment Company Act of 1940).

⁴⁵ STRUCTURED FINANCE, *supra* note 10, § 8:1, at 8-3.

⁴⁶ Thomas E. Plank, *The Security of Securitization and the Future of Security*, 25 CARDOZO L. REV. 1655, 1656 (2004) (referring to 2003 Domestic Financial Statistics showing that “[a]s of the end of 2002, there were more than 6 trillion dollars of outstanding securities issued in securitizations”).

Finally, the article examines the extent to which the analysis sheds light on the more general problem of business lawyers issuing legal opinions that create externalities.

THE NATURE OF LEGAL OPINIONS

Legal opinions are merely informed judgments, usually in writing, given by lawyers on issues of law.⁴⁷ Although legal opinions sometimes are directed to clients, in a transactional setting legal opinions often are provided, at the request of clients, to or for the benefit of third parties⁴⁸ such as financiers of credit or investors (“third-party” legal opinions).⁴⁹ Because the transactions requiring third-party legal opinions span the entire range of business and financial undertakings,⁵⁰ such opinions have become far more prevalent than opinions directed to clients.⁵¹ The vast majority of legal opinions in structured-finance transactions, including virtually all true-sale and non-consolidation opinions, are third-party legal opinions,⁵² typically provided to or for the benefit of the SPV’s investors by outside counsel to the originator.⁵³ The requirement that outside counsel provides these opinions helps assure independence and hence integrity of the opinions.⁵⁴

⁴⁷ TriBar Committees, *Legal Opinions to Third Parties: An Easier Path*, 34 BUS. LAW. 1891, 1896 (1979) (stating that a legal “opinion is not guaranty, but merely a lawyer’s informed judgment as to a specific question of law”).

⁴⁸ In the author’s experience, legal opinions occasionally are formally addressed to clients but substantively intended to benefit (or, at least, also benefit) third parties who are explicitly permitted to rely thereon. This article regards such opinions as third-party legal opinions.

⁴⁹ See generally JONATHAN R. MACEY, THIRD PARTY LEGAL OPINIONS: EVALUATION AND ANALYSIS 5-8 (1995) (discussing the purposes and uses of third-party legal opinions, and comparing such opinions to legal opinions issued to clients). See also Donald W. Glazer, Scott FitzGibbon, & Steven O. Weise, GLAZER AND FITZGIBBON ON LEGAL OPINIONS § 1.3.1, at 6 (2d ed. 2001) (noting that “the lender, acquiring company, investor or underwriter” makes use of closing opinions). For clarity, this article will refer to parties—whether the client or third parties—explicitly authorized to rely on legal opinions as “opinion recipients,” in contrast to other third parties, or the public.

⁵⁰ Third-party legal opinions are typically required, for example, in secured and unsecured financings, mergers and acquisitions, securities offerings, real estate transactions, debt financings, securitizations, and purchase agreements. See *id.* at 7.

⁵¹ Cf. GLAZER AND FITZGIBBON ON LEGAL OPINIONS, *supra* note 49, § 1.1, at 2 (referring to third-party legal opinions as a “fixture of the American legal scene”); Committee on Legal Opinions, ABA Section of Business Law, *Law Office Opinion Practices*, 60 BUS. LAW. 327 (2004) (observing that “[e]very week hundreds, if not thousands, of third party legal opinions are delivered at closings for business transactions”). See also Bryn Vaaler, *Bridging the Gap: Legal Opinions as an Introduction to Business Lawyering*, 61 UMKC L. REV. 23, 27 (1992) (describing third-party legal opinions as “[t]he most prevalent type of written opinion rendered by business lawyers”).

⁵² See generally STANDARD & POOR’S, LEGAL CRITERIA FOR U.S. STRUCTURED FINANCE TRANSACTIONS 173-74 (2004), available at http://www2.standardandpoors.com/spf/pdf/fixedincome/SF_legal_criteria_FINAL.pdf (discussing legal opinions required to rate various structured finance transactions).

⁵³ Even true-sale and non-consolidation opinions that are formally addressed to the client but substantively intended to benefit the SPV’s investors, who are explicitly permitted to rely thereon, are effectively third-party legal opinions. See *supra* note 48.

⁵⁴ In this context, it should be noted that investors are not misled due to agency problems—that attorneys are giving opinions to non-client third parties, whereas if they gave the opinions to their own clients the incentives would be more aligned and they would more likely inform their clients of problems. Even if

Third parties commonly require these opinions as a condition precedent to closing business transactions.⁵⁵ The opinions provide some assurance that, at least insofar as those parties have requested opinion coverage (coverage of a third-party legal opinion, although theoretically a private matter to be negotiated among the parties to a transaction, is often dictated by customary expectations of the opinion-recipients⁵⁶), nothing legally problematic lurks beneath the transaction's surface.⁵⁷ Lawyers providing the opinion apply applicable law to the transaction's particular facts in order to reach their legal conclusions.⁵⁸ In this sense, third-party legal opinions

third-party opinion recipients hired their own counsel, however, there is no reason to believe they would receive more accurate or informative opinions. Indeed, any misleading of investors is unrelated to the relationship between attorneys issuing the opinions and third parties receiving such opinions. The latter are investors in the SPV's securities, whereas only investors in the originator's securities are potentially misled. *See supra* notes 14-20 and accompanying text (explaining how investors are potentially misled). *See also Rethinking the Disclosure Paradigm in a World of Complexity, supra* note 20, at 6 n. 36 (distinguishing an originator's investors "from the very narrow and highly specialized class of sophisticated investors in securities issued by the SP[V]s that are parties to the originator's structured transactions").

⁵⁵ *See* The Committee on Legal Opinions, *Guidelines for the Preparation of Closing Opinions*, 57 BUS. LAW. 875, § 1.1 at 875 (2002) (stating that the "agreement for a business transaction will often condition a party's obligation to close on [a legal opinion's] receipt"). *Cf.* Section of Business Law, American Bar Association, *Third-Party Legal Opinion Report*, 47 Bus. Law. ___, at (i) (1991) (hereinafter "Silverado Report") (observing that "[c]ustom and practice have developed over the years pursuant to which a legal opinion is delivered at the closing to parties to the transaction (e.g., an acquiror, lenders or investors) other than the opinion giver's client"); TriBar Opinion Committee, *Third-Party "Closing" Opinions: A Report of the TriBar Opinion Committee*, 53 BUS. LAW. 591, 596 (1998) (stating that "[t]he relevant agreement in a business transaction will often provide for delivery of an opinion letter as a condition of closing").

⁵⁶ *See, e.g.,* TriBar Opinion Committee, *Third Party "Closing" Opinions*, 53 BUS. LAW. 591, § 5.5 at 640 (1998; hereinafter "TriBar 1998 Report") (observing that opinion recipients typically need certain information in the legal opinions and, therefore, such information has become customary in legal opinions); TriBar Committees, *Legal Opinions to Third Parties: An Easier Path, supra* note 47, at 1894 (observing that third-party legal opinions "have developed and evolved by a mixed pattern of custom, bargaining and need"). For example, a financier requesting a third-party legal opinion will want coverage at least as broad as that customarily expected by other financiers or investors, to facilitate resale of the securities issued in the transaction to other financiers or investors. [cite] Sometimes coverage is also dictated by regulatory law. *See* M. JOHN STERBA, JR., *LEGAL OPINION LETTERS: A COMPREHENSIVE GUIDE TO OPINION LETTER PRACTICE* § 1.3 1-10 (3d ed. 2003) (discussing securities regulations that require the issuance of legal opinions); *see also* ARTHUR NORMAN FIELD, *LEGAL OPINIONS IN BUSINESS TRANSACTIONS* § 1:3, at 1-4 n. 8 (2004) (citing New York regulatory requirement that requires opinions in bank mergers and acquisitions).

⁵⁷ *See* GLAZER AND FITZGIBBON ON LEGAL OPINIONS, *supra* note 49, § 1.1 at 2 (affirming that legal opinions are to assure the company that "it is getting what it thinks it is getting as a legal matter and that the transaction will not create any major legal problems"); MACEY, *THIRD PARTY LEGAL OPINIONS, supra* note 49, at 6 (stating that a "third party opinion may also be requested on the presumption that it will warn the recipient of any potential problems which may arise from the transaction"). *See also* FIELD, *LEGAL OPINIONS IN BUSINESS TRANSACTIONS, supra* note 56, § 1:5, at 1-5, 1-6 (describing role of legal opinions in providing some assurance to recipients that "property delivered at a closing ... has the desired legal characteristics and that the various provisions of a complex agreement, which purport to give a set of rights to each party, will be given effect by the courts").

⁵⁸ TriBar 1998 Report, *supra* note 56, § 2.1.1 at 608. Thus third-party legal opinions are not typically requested on legal issues whose analysis would be independent of the transaction's fact pattern. *See* Kaye Scholer Update 04-05 #2, at 1 (2004) (observing that legal opinions are only required on legal issues whose underlying facts are transaction specific) (unpublished manuscript on file with author).

operate to effectively reduce information asymmetry between parties to a transaction.⁵⁹ Correspondingly, the inability of counsel to deliver a requested opinion at closing signals a problem and allows opinion recipients to refuse to consummate the transaction.⁶⁰

However, neither third-party legal opinions nor legal opinions addressed to clients purport to evaluate a transaction's inherent business wisdom.⁶¹ At least heretofore, an opining lawyer has had no duty to evaluate the business merits of the underlying transaction beyond the obvious ethical and legal obligations of not knowingly furthering a fraudulent transaction.⁶²

⁵⁹ See Vaaler, *Bridging the Gap*, *supra* note 51, at 38 (discussing Professor Ronald Gilson's theory of "transaction cost engineering" as it relates to the role of third-party legal opinions in diminishing information asymmetry between transaction parties). I say that third-party legal opinions "effectively" reduce information asymmetry because, technically, recipients of such opinions often have the same factual information that opining counsel has. However, opining counsel assesses certain legal consequences of that information for the opinion recipients.

⁶⁰ Third-party legal opinions also can decrease risks to the recipient by arguably hindering the non-recipient party's ability to "attack[] the validity of the transaction" after closing. Koley Jessen, P.C., *Third-Party Legal Opinions: An Introduction to "Customary Practice"*, 35 CREIGHTON L. REV. 153, 155-56 (2001) (quoting George W. Bermant, *Third Party Legal Opinions*, C533 ALI-ABA 1337, 1348 (1990)). *But cf.* GLAZER AND FITZGIBBON ON LEGAL OPINIONS, *supra* note 49, § 1.3.2 at 11 (stating that even though it has been suggested that "[d]elivery of a third-party opinion letter may foreclose, or at least make it awkward for the other part to the transaction to assert, certain defenses in the event a dispute later arises under the agreement," it is unlikely that a legal opinion will "dissuade [a] company from asserting whatever defenses may be available to it or prevent a court from reaching its own legal conclusions"). Nevertheless, third-party legal opinions are an accepted (and sometimes almost mandatory) means of establishing due diligence on the part of a recipient corporation's directors. *Cf.* *Third-Party Legal Opinions: An Introduction to "Customary Practice," supra* at 156 (quoting Bermant that "[a]nother stated purpose is to satisfy the recipient that the lawyer has done due diligence and assured him/herself that all is right with the client"); *see also* SCOTT FITZGIBBON & DONALD W. GLAZER, FITZGIBBON AND GLAZER ON LEGAL OPINIONS § 1.3.2, at 8 (1992) (noting that "receipt of an opinion letter may help directors and officers establish that they have exercised care and acted in good faith if a transaction later turns out badly"); *id.* § 1.3.1, at 6-7 (stating that third-party legal opinions are "one of the building blocks in the opinion recipient's due diligence investigation"); FIELD, LEGAL OPINIONS IN BUSINESS TRANSACTIONS, *supra* note 56, § 1:3, at 1-3, 1-4 (stating that "[w]ithin the business community, legal opinions are widely recognized as forming an important part of the network of business diligence involved in significant transactions"); *Guidelines for the Preparation of Closing Opinions, supra* note 55, § 1.1 at 875 (declaring that "the closing opinion serves as a part of the recipient's diligence").

⁶¹ See SPECIAL REPORT BY THE TRIBAR OPINION COMMITTEE, OPINIONS IN THE BANKRUPTCY CONTEXT, *supra* note 31, at 727-28 (stating that "bankruptcy law opinions, like other opinions to third parties, only express views on specific issues of law and do not impose an obligation of providing general advice to the recipient"). *Cf.* *Guidelines for the Preparation of Closing Opinions, supra* note 55, § 1.4 at 876 (noting that the opinion giver should limit the opinion to the specific matter at hand, and should not include assumptions that are beyond the professional competence of lawyers).

⁶² *Id.* at 728 n. 34 (clarifying that "a lawyer cannot, in any circumstance, knowingly make a false statement of law or fact or knowingly assist a client in committing a fraud"); *Guidelines for the Preparation of Closing Opinions, supra* note 55, § 1.5 at 876 (stating that an "opinion giver should not render an opinion that the opinion giver recognizes will mislead the recipient"); TriBar 1998 Report, *supra* note 56, § 1.4(d) at 602 (reinforcing principle that a lawyer may not mislead the opinion recipient); RESTATEMENT (THIRD) OF THE LAW: THE LAW GOVERNING LAWYERS § 16 (comment c) ("a lawyer may not do or assist an unlawful act on behalf of a client").

Surprisingly, although third-party legal opinions are now almost universally required in large business and financial transactions,⁶³ their widespread use is relatively recent.⁶⁴ The relevant scholarly literature is thus sparse,⁶⁵ and the scholarship concerning lawyer conduct within the adversary legal system is largely inapplicable.⁶⁶ In past decades, however, bar associations and practitioners have tried to establish third-party legal opinion guidelines and best practices.⁶⁷ Because the central role of these opinions is reducing information asymmetry, it is generally agreed that the goal of opinion-givers is accuracy and fair presentation of legal conclusions derived from the transaction's particular facts.⁶⁸

⁶³ See FIELD, LEGAL OPINIONS IN BUSINESS TRANSACTIONS, *supra* note 56, § 1:3, at 1-3 (stating that “in most significant transactions, lawyers routinely propose the opinions to be given in their early drafts of documentation,” and that although “[t]he details of these opinions are often modified in the negotiations . . . the requirement for an opinion, once asserted, is seldom deleted altogether”).

⁶⁴ See *Third-Party Legal Opinions: An Introduction to “Customary Practice,”* *supra* note 60, at 155 (observing that third-party legal opinions came into existence “only in the last forty years or so”). *But cf.* GLAZER AND FITZGIBBON ON LEGAL OPINIONS, *supra* note 49, at 2 n. 5 (noting the existence of an 1899 third-party legal opinion, given by the firm Wood & Oakley).

⁶⁵ The following articles, some more scholarly than others, touch on third-party legal opinions: Thomas L. Ambro & J. Truman Bidwel, Jr., *Some Thoughts on the Economics of Legal Opinions*, 1989 COLUM. BUS. L. REV. 307; Donald W. Glazer & Charles R.B. Macedo, *Determining the Underlying Facts: An Epistemological Look at Legal Opinions in Corporate Transactions*, COLUM. BUS. L. REV. 343 (1989); Richard R. Howe, *The Duties and Liabilities of Attorneys in Rendering Legal Opinions*, 1989 COLUM. BUS. L. REV. 283; *Third-Party Legal Opinions: An Introduction to “Customary Practice,”* *supra* note 60 (providing historical background); John C. Quale & Brian D. Weimer, *Legal Opinions in Corporate Transactions Affected by FCC Regulation: An Economic Approach*, 51 FED. COMM. L.J. 773 (1999). Prof. Macey also has written a book on third-party legal opinions, but it is primarily descriptive. See MACEY, THIRD PARTY LEGAL OPINIONS, *supra* note 49. Professor Lipson is in the process of writing a comprehensive scholarly article exploring third-party legal opinion practice. Jonathan C. Lipson, “Price and Pride: Third-Party Closing Opinion Practice Among U.S. Lawyers (A Preliminary Investigation)” (Feb. 16, 2005) (unpublished manuscript on file with author).

⁶⁶ See *infra* text accompanying notes 135-149 & 324-325 (explaining why that scholarship is inapplicable).

⁶⁷ The seminal works are James J. Fuld, *Legal Opinions in Business Transactions—An Attempt to Bring Some Order Out of Chaos*, 28 BUS. LAW. 915 (1973), TriBar Committees, *Legal Opinions to Third Parties: An Easier Path*, *supra* note 47; Silverado Report, *supra* note 55; *Guidelines for the Preparation of Closing Opinions*, *supra* note 55; TriBar 1998 Report, *supra* note 56; The Committee on Legal Opinions, *Legal Opinion Principles*, 53 BUS. LAW. 831 (1998; hereinafter “*Legal Opinion Principles*”). There are, however, a multitude of practitioner-oriented articles. See GLAZER AND FITZGIBBON ON LEGAL OPINIONS, *supra* note 49, at SB:1–SB:20.

⁶⁸ See generally FIELD, LEGAL OPINIONS IN BUSINESS TRANSACTIONS, *supra* note 56, §§ 4:1 – 4:6, at 4-1 – 4-7 (describing opining lawyer as “akin to that of a judge preparing a decision in a case, rather than that of an advocate for the client”; *id.* at 4-2, stating that “the opinion given must be fair and objective”; & *id.* at 4-1, detailing the process of the opining lawyer acting as a “hypothetical contemporaneous court” in applying the law within the factual framework of a particular transaction). See also FITZGIBBON AND GLAZER ON LEGAL OPINIONS, *supra* note 60, § 3.3, at 55 (asserting that “[b]ecause the analysis included in a reasoned opinion is intended to inform, it should be fair, balanced, and objective. As the ABA Guidelines correctly point out, reasoned opinions should not be ‘an exercise in advocacy’”). *Guidelines for the Preparation of Closing Opinions*, *supra* note 55, §3.1 at 878 (outlining the “Golden Rule” in closing opinions, that all requests and disclosures should abide by a general notion of fairness and professionalism). See also GLAZER AND FITZGIBBON ON LEGAL OPINIONS, *supra* note 49, § 1.8 at 32 (arguing that the “opinion process should never be allowed to become a game in which one side wins and the other side loses Rather, the preparation and delivery of a closing opinion in a business transaction should be an exercise in professionalism in which both sides work together to reach a sensible result”).

Sometimes, though, third-parties request opinions on issues where the law is undeveloped, unsettled, or otherwise not subject to black-letter certainty. Many issues arising from an originator’s bankruptcy, for example, present a degree of uncertainty.⁶⁹ Nonetheless, assuming they have sufficient expertise, lawyers traditionally will attempt to issue a requested opinion where there is enough precedent or other authority to enable a degree of ex ante prediction.⁷⁰

In those cases, lawyers normally issue “reasoned” opinions.⁷¹ These are legal opinions that, rather than setting forth black-letter legal conclusions, engage in a substantive discussion of the applicable law and qualify that discussion as appropriate with reasonable assumptions, cautionary language, and disclosure of uncertainties.⁷² If opinion-recipients wish to proceed with the transaction despite these cautions and uncertainties, they do so forewarned and at their own risk.⁷³ All structured-finance opinions are reasoned opinions, typically ranging 20-50 pages in length,⁷⁴ and their function is to reduce information asymmetry between the parties to the structured-finance transaction regarding bankruptcy remoteness—the primary issue of concern to the SPV’s investors.⁷⁵

⁶⁹ See *supra* note 31.

⁷⁰ FIELD, LEGAL OPINIONS IN BUSINESS TRANSACTIONS, *supra* note 56, § 2:4, at 2-5.

⁷¹ SPECIAL REPORT BY THE TRIBAR OPINION COMMITTEE, OPINIONS IN THE BANKRUPTCY CONTEXT: RATING AGENCY, STRUCTURED FINANCING AND CHAPTER 11 TRANSACTIONS, *supra* note 31, at 34. See also TriBar Committees, *Legal Opinions to Third Parties: An Easier Path*, *supra* note 47, at 1895 (observing that “it is inappropriate to seek to require an unqualified opinion on an uncertain or disputed legal principle”). See also STERBA, JR., LEGAL OPINION LETTERS: A COMPREHENSIVE GUIDE TO OPINION LETTER PRACTICE, *supra* note 56, § 1.4, at 1-12 (stating that a reasoned opinion “may be advisable either because the law itself is unclear, the facts are not entirely straightforward, or the lawyer believes there are reasonable arguments that might lead to a different legal interpretation than the one the opining lawyer favors”); FIELD, LEGAL OPINIONS IN BUSINESS TRANSACTIONS, *supra* note 56, § 2:4, at 2-5 (discussing the use of reasoned opinions where unqualified opinions would improperly gloss over the unsettled nature of a legal issue). Cf. GLAZER AND FITZGIBBON ON LEGAL OPINIONS, note 49, § 3.3 at 78-79 (noting that even when they may be confident in a certain outcome, opinion preparers may “chose to spell out their reasoning to alert the opinion recipient to the contrary authority and to provide it the opportunity to obtain the views of its own counsel”).

⁷² *Id.*

⁷³ TriBar Committees, *Legal Opinions to Third Parties: An Easier Path*, *supra* note 47, at 1895-96 (stating that “[i]f the opinion is qualified or uncertain, the addressee is on notice of certain elements of limitation and should then satisfy itself as to the risks of proceeding with the transaction in view of those limitation”); TRIBAR OPINION COMMITTEE, OPINIONS IN THE BANKRUPTCY CONTEXT, *supra* note 31, at 738 (stating TriBar Opinion Committee’s belief that “[a] reasoned opinion is sufficient to put the opinion recipient on notice as to the uncertainties and limitations . . . inherent in opining on those bankruptcy law matters covered in the opinion”).

⁷⁴ This estimate is based on the author’s experience.

⁷⁵ See, e.g., Schwarcz, *The Alchemy of Asset Securitization*, *supra* note 12, at 135-36 (explaining the two elements of bankruptcy remoteness—a true sale for bankruptcy purposes of receivables from the originator to the SPV, and protection of the SPV from the originator’s bankruptcy—and observing that investors in the SPV’s securities require bankruptcy remoteness). Structured-finance opinions address these precise two elements: whether there is a bankruptcy true sale, and whether the SPV could be substantively consolidated with the originator’s estate in bankruptcy. See *supra* notes 23 & 26.

Having discussed the nature of legal opinions, including structured-finance opinions, I next examine the criticisms of those opinions in historical context. References below to structured-finance opinions mean reasoned, third-party, structured-finance opinions.⁷⁶

ASSESSING THE CRITICISMS OF STRUCTURED-FINANCE OPINIONS

Commentators have advanced, essentially, three criticisms of structured-finance opinions: (i) wherever there are sufficient warning signs, a lawyer should go beyond the technical terms of the opinion and affirmatively investigate the transaction for fraud;⁷⁷ (ii) a lawyer should have an obligation to advise his or her client, and perhaps other opinion recipients, whether the entire transaction is legal or not;⁷⁸ and (iii) irrespective of whether a legal opinion is technically correct, it is misleading if it does not fairly present the situation.⁷⁹ To assess these criticisms, one must first understand the historical debate over whether, and the extent to which, lawyers have a responsibility to the public—especially when issuing legal opinions—in addition to their responsibility to clients or the opinion recipient. The criticism of structured-finance opinions is ultimately intertwined with that debate.

A. The Historical Debate Over a Lawyer’s Public Responsibility

At common law, “an attorney has been traditionally viewed as owing a duty only to the specific client for whom he performed his professional service.”⁸⁰ Nonetheless, it often has been observed that attorneys function as officers of the court in addition to their role as advocates and counselors to their clients.⁸¹ That former capacity might appear to imbue attorneys with some measure of public responsibility.

During the formative years of common-law development, however, there was little if any real conflict between an attorney’s responsibility to a client and to the public. Therefore there was little need to try to define that latter responsibility. The need to balance client and public responsibilities became more acute, though, after passage of the federal securities laws.⁸² These

⁷⁶ This reflects that virtually all structured-finance opinions are third-party reasoned legal opinions. *See supra* notes 52-54 & 74 and accompanying text.

⁷⁷ *See infra* notes 93-100 and accompanying text.

⁷⁸ *See infra* notes 101-104 and accompanying text.

⁷⁹ *See infra* notes 105-114 and accompanying text.

⁸⁰ Marshall L. Small, *An Attorney’s Responsibilities Under Federal and State Securities Laws: Private Counselor or Public Servant?*, 61 CAL. L. REV. 1189, 1194 (1973).

⁸¹ *See, e.g.*, Preamble[1] to ABA Model Rules of Professional Conduct (2002): “A lawyer, as a member of the legal profession, is a representative of clients, an officer of the legal system and a public citizen having special responsibility for the quality of justice.”

⁸² These laws, codified at 15 U.S.C. §§ 77-80, primarily consist of the Securities Act of 1933 (“’33 Act”), codified at 15 U.S.C. §§ 77 et seq., and the Securities Exchange Act of 1934 (“’34 Act”), codified at 15 U.S.C. §§ 78 et seq. For an argument that lawyers were viewed, even prior to enactment of these laws, as having public responsibility as well as a duty to the client, *see* Robert W. Gordon, *A New Role for Lawyers?: The Corporate Counselor After Enron*, 35 CONN. L. REV. 1185, 1207-08 (2003) (citing AMERICAN BAR ASSOCIATION, CODE OF PROFESSIONAL ETHICS Canon 32 (1908): “No client, corporate or individual, however powerful, nor any cause, civil or political, however important, is entitled to receive, nor should any lawyer render, any service or advice involving ... deception or betrayal of the public”). Professor Gordon also observes that although, in the post-World War II era, a prominent “group of lawyers and legal academics ... theorized ... the role of the new corporate legal counselor as a ‘statesman-advisor’” seeking the client’s “long-range social benefit.” Gordon, *A New Role for Lawyers?*, *supra* at 1208. That role, however, does not necessarily appear to impose a public responsibility on the lawyer; instead, it might

laws governed, among other things, the lawyer's role in preparing disclosure to investors of the risks associated with offerings of securities.⁸³

As a result, shortly after these laws' enactment, one leading commentator predicted "a restatement of the attorney's answerability to the court and to society, and a reminder that he is not an ordinary employee of his client."⁸⁴ The chief justice of the Supreme Court similarly commented on the need to examine a lawyer's public responsibility, lamenting that the increased need of business and finance for the best lawyers "[a]t its worst ... has made the learned profession of an earlier day the obsequious servant of business, and tainted it with the morals and manners of the market place in its most anti-social manifestations."⁸⁵ Even those who disagreed with this view admitted that business pressures were blurring the line between a lawyer's duty to the client and the public.⁸⁶

Nonetheless, only decades later, in 1973, did anyone begin to systematically examine a lawyer's public responsibility—by attempting to answer the narrow question, "to whom are the securities lawyer's duties owed?"⁸⁷ As that question suggests, the debate over a lawyer's responsibility to the public has, at least to date, been largely limited to the responsibility of securities lawyers.⁸⁸ And, even in that limited context, much of the recent debate has focused on

well reflect the long-standing corporate-law debate over whether directors should manage for immediate or long-term profits. *See, e.g.*, *Dodge v. Ford Motor Co.*, 170 N.W. 668 (Mich. 1919) (discussing that debate). In any event, Gordon notes that, since the 1970s, this role "has been in decay," and now "has almost no institutional support in the rules and disciplinary bodies that regulate the [legal] profession." Gordon, *A New Role for Lawyers?*, *supra* at 1209.

⁸³ For example, a legal opinion provided to an underwriter in connection with an offering of securities may support the "due diligence" defense available under the Securities Act of 1933. 15 U.S.C. 77k(b) (2004). Likewise, Regulation S-K, an administrative interpretation of the Securities Act, requires as an exhibit to the registration statement "[a]n opinion of counsel as to the legality of securities being registered, indicating whether they will, when sold, be legally issued, fully paid and non-assessable, and, if debt securities, whether they will be binding obligations of the registrant." 17 C.F.R. § 229.601(b)(5). *See* Lipson, "Price and Pride," *supra* note 65, at 22-23.

⁸⁴ Nathan Isaacs, *Liability of the Lawyer for Bad Advice*, 24 CAL. L. REV. 39, 45-47 (1935).

⁸⁵ Harlan F. Stone, *The Public Influence of the Bar*, 48 HARV. L. REV. 1, 7 (1934).

⁸⁶ *See, e.g.*, Swaine, *The Impact of Business of the Profession: An Answer to Critics of the Modern Bar*, 35 A.B.A. J. 89 (1949); Freeman, *Opinion Letters and Professionalism*, *supra* note 29, at 373-74.

⁸⁷ Small, *An Attorney's Responsibilities Under Federal and State Securities Laws*, *supra* note 80, at 1191. *See also* Freeman, *Opinion Letters and Professionalism*, *supra* note 29 (similarly beginning to systematically examine a lawyer's public responsibility).

⁸⁸ Small, for example, focuses on a lawyer's responsibilities only when rendering explicit securities-law legal opinions (Small, *An Attorney's Responsibilities Under Federal and State Securities Laws*, *supra* note 80, at 1192-1207) or when "acqui[ring] and disseminati[ng] ... information in the securities field" (*id.* at 1207). Moreover, the debate over a lawyer's public responsibility appears to be even more narrowly focused on privity of contract and the question of whether attorneys who otherwise violate securities law should be held liable to investors who are not their clients. *See, e.g.*, Gary Lawson & Tamara Mattison, *A Tale of Two Professions: The Third-Party Liability of Accountants and Attorneys for Negligent Misrepresentation*, 52 OHIO ST. L.J. 1309 (1991). *But see* John C. Coffee, Jr., *The Attorney as Gatekeeper: An Agenda for the SEC*, 103 COLUM. L. REV. 1293 (2003) (advocating a "gatekeeper" function for securities lawyers so as to diminish the harm of defective disclosures to the investing public).

the technical issue of securities lawyer exposure to “aiding-and-abetting” liability, rather than on normative responsibility.⁸⁹

In contrast, recent events, including the Enron and WorldCom debacles, not only have made the debate over a lawyer’s public responsibilities more urgent but, significantly, have expanded the debate’s scope beyond that of securities law or securities lawyers per se. Lawyers issuing structured-finance opinions, or other opinions associated with off-balance-sheet financing, are neither acting as securities lawyers nor expressing opinions on securities law.⁹⁰ They are, nevertheless, opining on matters that may impact, albeit indirectly, disclosure to investors of corporate information. Should these lawyers be responsible to the public for the ultimate use that is made of their opinions, *even if their opinions are neither incorrect nor misleading on their face?*⁹¹ This article focuses on that larger debate.

⁸⁹ That debate concerns whether lawyers who participate in securities fraud can be held liable, as aiders and abettors, in private causes of action under §10(b) of the Securities and Exchange Act of 1934 (15 U.S.C.A. §78j(b)) or Rule 10b-5 thereunder (17 CFR §240.10b-5). In *Central Bank v. First Interstate Bank*, 511 U.S. 164 (1994) the Supreme Court held that only primary actors, not aiders and abettors, could be so held liable. *Id.* at 175, 180. Therefore, only if lawyers act as primary violators of Rule 10b-5, such as by employing a manipulative device or making a material misstatement or omission in connection with the sale of securities, could they be held liable in a private cause of action. *Id.* at 191. Subsequent to the *Central Bank* decision, lower courts have developed two divergent theories as to when primary liability could attach to a secondary actor, such as a lawyer, for merely participating in the conduct proscribed under §10(b). Under the first “bright-line” theory, the secondary actor must make a material misrepresentation or omission that is attributed to that actor at the time of public dissemination to be liable as a primary violator. *See, e.g., Wright v. Ernst & Young LLP*, 152 F.3d 169, 175 (2d Cir. 1998); Aegis J. Frumento, *Misrepresentations of Secondary Actors in the Sale of Securities: Does In re Enron Square with Central Bank?*, 59 BUS. LAW. 975, 980-81 (2004) (discussing the emergence of lower courts theories as to when primary liability could be imposed on secondary actors under §10(b) after the *Central Bank* opinion). Under the second “substantial participation” theory, the secondary actor need only have substantially participated or been intricately involved in the preparation of fraudulent statements even if the secondary actor did not actually make the statements. *Howard v. Everex System, Inc.*, 228 F.3d 1057, 1061 n. 5 (9th Cir. 2000). *Cf. Freeman, Opinion Letters and Professionalism, supra* note 29, at 424 & 421-24 (arguing that issuing a legal opinion to be used to achieve misleading accounting treatment is “the essence of actionable aiding and abetting under the securities laws”). The substantial participation test has been widely criticized, though, as being inconsistent with the holding of *Central Bank*. *See, e.g., Frumento, Misrepresentations of Secondary Actors in the Sale of Securities, supra* at 995-1001. Recently, the court in *In re Enron Corp. Securities, Derivative & ERISA Litigation, supra* note 4, adopted a third “creation” theory, suggested by the SEC, under which a secondary actor who creates a misrepresentation, whether acting alone or with others and irrespective of whether his identity is disclosed to investors, can be liable as a primary violator under §10(b) provided he acts with the requisite scienter. *Id.* at 586-589. This theory also has been criticized as being inconsistent with the Supreme Court’s holding in *Central Bank*. Frumento, *Misrepresentations of Secondary Actors in the Sale of Securities: Does In re Enron Square with Central Bank?*, *supra* at 996. There is no question, though, that a secondary actor who aids and abets securities fraud under §10(b), whether or not subject to a private cause of action, could be liable under 18 U.S.C. § 2, which imposes criminal liability of the principal actor on aiders and abettors. *See* 15 U.S.C. § 77t(e)(2000); *Central Bank*, 511 U.S. 164 at 190.

⁹⁰ *See supra* note 23 and accompanying text (noting that structured-finance opinions address only bankruptcy-law issues).

⁹¹ There is no implication here that these lawyers should have some duty to advise on securities law; separate securities-law counsel are virtually always engaged for transactions involving the issuance of securities. *Cf. Larry Soderquist, Understanding the Securities Laws* § 1.1 (4th ed. 2004) (“Although there may be areas of law a bright lawyer easily can learn on his or her own from the statutes, rules, and cases, federal securities law is not one of them. Give an eager and talented, but uninitiated, lawyer the Securities

Having provided this historical context, I next attempt to assess the criticisms of structured-finance opinions advanced by commentators.⁹²

B. Assessing the Criticisms of Structured-Finance Opinions

The first criticism: The first criticism is that, wherever there are sufficient “red flags,” or warning signs, a lawyer should go beyond the technical terms of the opinion and affirmatively investigate the transaction for fraud.⁹³ Lawyers should not be able to say, for example, that they did not understand why certain unusual documents are used in a transaction. One commentator thus argues that if counsel in Dynegy’s “Project Alpha” transaction⁹⁴ investigated why the parties entered into highly unusual “tear-up” documents, they would have found that Project Alpha was structured to achieve inappropriate off-balance-sheet treatment for what was effectively a lending transaction.⁹⁵

I agree in concept that where there are sufficient warning signs, a lawyer *should*—out of concern for integrity and reputation much less the need to understand the relevant aspects of a transaction on which he or she is opining since the opinion, which applies law to facts, is based on that understanding—affirmatively investigate for fraud.⁹⁶ The trick, though, is identifying what constitutes warning signs: some “red flags” may be (metaphorically) furred and hard to see, whereas orange flags sometimes might appear red. As an example of the latter, the commentator mentioned above⁹⁷ naively alleges that where an SPV is used as a “financing vehicle,” a true-sale legal opinion is necessarily misleading because the transaction must be regarded as a loan.⁹⁸ This commentator fails to recognize that virtually all structured-finance transactions have loan-like economics,⁹⁹ a fact irrelevant to a true-sale determination.¹⁰⁰

Act of 1933 and its rules and cases, provide a few weeks of cloistered study, and the lawyer is likely to emerge encyclopedic but confused.”). To the extent necessary, however, securities lawyers preparing the disclosure ought to consult structured-finance counsel—even if such counsel are at different firms—to ensure they’re accurately disclosing the structured-finance transaction.

⁹² Those criticisms were summarized *supra* notes 77-79 and accompanying text.

⁹³ See Koppel, *Wearing Blinders*, *supra* note 3, at 164 (attributing this argument to Deborah Rhode, a professor of law at Stanford Law School). See also Gordon, *A New Role for Lawyers?*, *supra* note 82, at 1193, 1201 (arguing that lawyers may need to inquire beyond their limited role where they suspect problems).

⁹⁴ This transaction is described in Koppel, *Wearing Blinders*, *supra* note 3.

⁹⁵ *Id.* at 164.

⁹⁶ This does not mean, however, that the lawyer should investigate for fraud in the sense that a district attorney would investigate. See *infra* notes 190-192 and accompanying text (arguing that opining counsel only need investigate sufficiently to see if the warning sign can be dispelled and the requested opinion given).

⁹⁷ See *supra* text accompanying note 94.

⁹⁸ Koppel, *Wearing Blinders*, *supra* note 3, at 164.

⁹⁹ Steven L. Schwarcz, *Commercial Trusts as Business Organizations: Unraveling the Mystery*, 58 BUS. LAW. 559, 562-63 (2003).

¹⁰⁰ Steven L. Schwarcz, *Collapsing Corporate Structures: Resolving the Tension Between Form and Substance*, 60 BUS. LAW. 109 (2004) (explaining why loan-like economics is not, and should not be, a basis for recharacterizing a “sale” structure as a loan).

The second criticism: The second criticism is that a lawyer should have an obligation to advise the client, and perhaps other opinion recipients, about the legality of transactions being opined on.¹⁰¹ Thus, the lawyer should ask, irrespective of how an accountant would view a transaction, “is this [transaction] fraudulent or designed to mislead investors?”¹⁰²

This stance is especially problematic where outside counsel are asked to opine only on certain aspects of a transaction. Examining the entire transaction then would be costly. It is questionable if this cost is justified, *especially since companies generally have no de novo obligation to retain counsel when engaging in business transactions*. If this cost is not justified, counsel only should be obligated to assess the legality of the relevant portions of transactions on which they are opining¹⁰³—recognizing, of course, that if counsel spot warning signs in the course of that assessment, they should investigate further to the extent discussed above.¹⁰⁴

The third criticism: The third criticism of structured-finance opinions is that an opinion is misleading, irrespective of whether it is technically correct,¹⁰⁵ if it does not fairly present the situation.¹⁰⁶ This criticism has several fallacies. Exactly which situation, for example, should an opinion be fairly presenting where counsel opines only on certain aspects of a transaction? Examining the entire transaction then would be costly. To avoid unnecessary costs, it would appear that opinion givers should strive for fair presentation only of the legal conclusions derived from the transaction’s particular facts—e.g., whether there has been a true sale, and whether substantive consolidation is likely.¹⁰⁷

¹⁰¹ Koppel, *Wearing Blinders*, *supra* note 3, at 166 (attributing this argument to George Cohen, an ethics professor at University of Virginia School of Law).

¹⁰² *Id.* See also Enron Examiner's Report App. C (Role of Enron's Attorneys), at 12 (discussing the duties of Rex Rogers, the Enron in-house attorney primarily responsible for securities disclosure, and concluding that “a fact-finder could determine that Rogers committed malpractice based on negligence for his failure to inform himself about the [SPV] transactions so that he could properly advise Enron with respect to the disclosure issues raised by these transactions”).

¹⁰³ Counsel need to understand the relevant portions of a transaction on which they are opining because their opinion, which applies law to facts, is based on that understanding. See *supra* note 96 and accompanying text. An obvious corollary of this need-to-understand is that counsel’s understanding has a reasonable basis. See, e.g., *Roberts v. Ball, Hunt, Hart, Brown & Baerwitz*, 128 Cal. Rptr. 901, 906 (1976) (observing that “[w]here a defendant [in that case, a law firm] makes false statements, honestly believing them to be true, but without reasonable grounds for such belief, he may be held liable for negligent misrepresentation, a form of deceit”).

¹⁰⁴ See *supra* notes 96-98 and accompanying text.

¹⁰⁵ This case should be distinguished from the situation where a professional’s technical due diligence is insufficient because, in light of the professional’s special knowledge and continuity of conduct, the professional should have known the advice is misleading. See, e.g., *Bentel v. U.S.*, 13 F.2d 327, 329 (2d Cir. 1926) (observing that “there are many cases where from the actor’s special situation and continuity of conduct an inference that he *did* know the untruth of what he said or wrote may be drawn”) (emphasis added). See also *U.S. v. Benjamin*, *infra* note 280, at 861-62 (applying this principle to find that “[a]ny accountant must know that his obligations in certifying ‘pro forma’ [financial] statements are not satisfied by any such arithmetical exercise as [the accountant therein charged] performed”). My article, however, assumes there is no *mens rea*. See text accompanying note 33, *supra*.

¹⁰⁶ Koppel, *Wearing Blinders*, *supra* note 3, at 165-66.

¹⁰⁷ *Cf. supra* note 68 (observing that because the central role of third-party legal opinions is reducing information asymmetry, it is generally agreed that the goal of opinion-givers is accuracy and fair presentation of legal conclusions derived from the transaction’s particular facts).

More significantly, the criteria for fair presentation of a company's financial condition and results of operations are already dictated by GAAP accounting. GAAP comprises a set of standards for financial accounting and reporting, officially recognized as authoritative by the SEC,¹⁰⁸ providing the "credib[ility], transparen[cy], and comparab[ility]" needed for "the efficient functioning of the economy."¹⁰⁹ Because it is highly technical and voluminous,¹¹⁰ knowledge about, much less expertise in, GAAP is well beyond the learning of most attorneys.¹¹¹ Any attempt to require attorneys to second-guess accounting determinations would likely create confusion.¹¹² So long as GAAP governs what constitutes a fair presentation of a company's

¹⁰⁸ See *supra* note 41. See also FINANCIAL ACCOUNTING STANDARDS BOARD, FACTS ABOUT FASB 1 (2003-2004) (available at www.fasb.org) and SEC Financial Reporting Release No. 1, Section 101.

¹⁰⁹ FACTS ABOUT FASB, *supra* note 108, at 1.

¹¹⁰ Sofia Adroque & Alan Ratliff, *Kicking the Tires after Kumho: The Bottom Line on Admitting Financial Expert Testimony*, 37 HOUS. L. REV. 431, 486-87 (2000) ("A consideration of the body of authority, guidance, and literature on accounting standards ... makes clear that, by any objective standard, understanding accounting issues involves technical and specialized knowledge.").

¹¹¹ See, e.g., David F. Birke, *The Toothless Watchdog: Corporate Fraud and the Independent Audit—How Can the Public's Confidence Be Restored?*, 58 U. MIAMI L. REV. 891, 904 (2004) ("As any former or practicing auditor can attest, GAAP can create a labyrinth of complex rules that only an experienced auditor could hope to understand."). This does not impugn Professor Cunningham's fundamental observation, with which I agree, that "[i]f business lawyers invariably confront questions of law and accounting in their practice, and it is difficult to understand core concepts and key cases in corporate law without a firm footing in accounting, it is incumbent upon the legal professorate to assure it provides adequate teaching." Lawrence A. Cunningham, *Sharing Accounting's Burdens: Business Lawyers in Enron's Dark Shadow*, 57 BUS. LAW. 1421, 1449 (2002). There is, however, a vast gap between understanding core concepts and applying technical accounting rules. Cunningham may be conflating the two by calling, *id.* at 1456, for business lawyers to "make it a professional habit to stay abreast of the top handful of hot topics of debate within the accounting profession and also understand the accounting aspects of transactions they are involved with (e.g., true sale rules, leasing rules, and derivatives rules." Lawyers should not, however, be obligated to apply technical accounting rules. See, e.g., William H. Widen, *Enron at the Margin*, 58 BUS. LAW. 961, ___ (2003), in which Professor Widen, a partner at Cravath, Swaine & Moore prior to becoming a full-time academic, argues that

[s]ome [meaning Cunningham] suggest that lawyers should now become more active in client accounting and some advocate expanded accounting education for lawyers. ... This essay argues for caution. While lawyers should develop enough knowledge to spot some accounting issues, it is unrealistic to suppose that attorneys will serve as extra, consulting accountants. That would require too much training and it would require lawyers to keep up with accounting developments as well as legal ones. Most attorneys would not have the time. Moreover, lawyers would need to think very hard before taking actions that would cause them to voluntarily shoulder the liabilities, as well as the other "burdens," that accountants carry today.

See also *id.* at 962 (arguing that "[t]he cultural problem revealed by Enron ultimately is not subject to correction by teaching lawyers more accounting ..."). Professor Cunningham himself, upon reflection, may well be in agreement. Cf. Cunningham, *Sharing Accounting's Burdens*, *supra* at 1455: "As a technical matter, the duty of competence may not call for a law firm's involvement in discussing appropriate accounting treatment."

¹¹² See, e.g., e-mail from Richard Painter, Guy Raymond & Mildred Van Voorhis Jones Professor of Law, University of Illinois, and newly-appointed White House Chief Ethics Officer, to the author (Feb. 13, 2005) (observing that although the concept that a legal opinion should fairly present the situation is "sound in principal," it is "notoriously vague if used to impose liability on lawyers" and therefore might serve as a "definition of professionalism, but not as grounds for civil liability").

financial position and results of operations, independent public accountants, not attorneys,¹¹³ should make that determination.¹¹⁴

The foregoing assessment shows that none of these criticisms of structured-finance opinions, other than to some degree the first, is compelling. The first criticism does not, however, provide a systematically rigorous framework for analysis. I therefore next attempt to construct such a framework.

BUILDING A SYSTEMATIC FRAMEWORK FOR ANALYSIS

Because there is little precedent,¹¹⁵ my inquiry proceeds from fundamental principles. First, I analyze whether constraints should bind structured-finance opinions and the lawyers

¹¹³ Whatever merit there may be to the recent Sarbanes-Oxley requirement for *management* certification of fair presentation (*see infra* note 293), lawyers—and especially outside lawyers—are neither trained nor sufficiently informed to judge fair presentation. *Cf.* John C. Coffee, Jr., *The Attorney as Gatekeeper: An Agenda for the SEC*, 103 COLUM. L. REV. 1293, 1312-15 (2003) (advocating that “the attorney principally responsible for preparing a disclosure document or report filed with the SEC [be required] to certify: (1) that such attorney believes the statements made in the document or report to be true and correct in all material respects; and (2) that such attorney is not aware of any additional material information whose disclosure is necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading”).

¹¹⁴ This does not mean that accountants and lawyers should not attempt to work together in appropriate cases. Professor William Simon argues for a more fully interdisciplinary regime in order to avoid the possibility of a “perfect circle of lack of responsibility.” Remarks of William H. Simon, Arthur Levitt Professor of Law, Columbia Law School, at March 21, 2005 Columbia Law School Symposium on this article. *Cf.* Cunningham, *Sharing Accounting’s Burdens*, *supra* note 111, at 1454: “A familiar pass-the-buck pas de deux in deal meetings and conference calls occurs when the accountant says, after an impasse, ‘that’s a legal problem’ while the lawyer says ‘that’s an accounting problem.’ Frequently the truth is what’s not said: both are right. Each should be more willing to venture into the other’s territory” A fully interdisciplinary regime, however, is likely to involve high transaction costs, whereas the practical possibility of there being a “perfect circle of lack of responsibility” is mitigated by the overlap between financial disclosure required under GAAP and securities-law disclosure required under SEC Rule 10b-5. *See infra* note 166 and accompanying text (observing that offering documents, such as prospectuses, independently must disclose any material risks in order to comply with SEC Rule 10b-5).

¹¹⁵ Although there is little precedent directly on point, I have examined the tax-shelter opinion precedents to determine their potential applicability. Those precedents superficially appear relevant because they address the duties of attorneys issuing legal opinions to third-party investors (discussing the expected tax treatment of tax shelters). *See, e.g.*, Richard Lavoie, *Deputizing the Gunslingers: Co-Opting the Tax Bar into Dissuading Corporate Tax Shelters*, 21 VA. TAX REV. 43 (2001). The pattern of tax-shelter opinions, however, turns out to be too fundamentally different to serve as precedents. Unlike structured-finance opinions or, indeed, any of the other third-party business law opinions later discussed, tax-shelter opinions are not negotiated between sophisticated business parties but, instead, are typically written *ex ante* as marketing tools for the “promoter” of the tax shelter to help sell investments in the shelter. Lavoie, *Deputizing the Gunslingers*, *supra* at 50. Moreover, the externality caused by aggressive tax avoidance—less tax revenue—is distributed diffusely among the public at large. Perhaps for this reason, minimization of tax liability traditionally has been viewed in the United States as a legitimate goal, in and of itself. *Chamberlain v. Commissioner*, 207 F.2d 462, 468 (6th Cir. 1953). Only where tax-shelter opinions facilitate abusive transactions that ultimately lack economic substance by, for example, relying on excessively textualist readings of the Internal Revenue Code or making unsubstantiated assumptions about the underlying facts of a transaction are they even criticized. *See, e.g.*, Noel B. Cunningham & James R. Repetti, *Textualism and Tax Shelters*, 24 VA. TAX REV. 1, 4 (2004); Peter C. Canellos, *Business Purpose, Economic Substance, and Corporate Tax Shelters: A Tax Practitioner’s Perspective on Substance, Form and Business Purpose in Structuring Business Transactions and in Tax Shelters*, 54 SMU L. REV. 47, 48

providing them, showing that the main justification for imposing constraints in this context is to minimize externalities. Next, I examine the externalities resulting from structured-finance opinions, and the corresponding appropriateness of constraints. Finally, I expand that analysis to examine more generally the externalities resulting from, and constraints appropriate for, other third-party business law opinions. (In these contexts, note that the third parties affected by externalities caused by these opinions are not the “third-party” recipients of such opinions; the latter are effectively “contracting” parties,¹¹⁶ the former the public at large who invest in the originator’s securities.¹¹⁷)

A. What Constraints Should Bind Structured-Finance Opinions and the Lawyers Issuing Them?

To begin this inquiry, recall the typical nature of structured-finance opinions: they are technically correct as to the matters they cover;¹¹⁸ they address only bankruptcy-law matters, and make no accounting analysis;¹¹⁹ and counsel rendering these opinions do not intend them to be used to achieve misleading accounting results or otherwise mislead the public.¹²⁰ What constraints should bind these opinions and the lawyers issuing them?

Conceptual framework for analysis: Many terms, some with overlapping meanings,¹²¹ are used to describe why government imposes constraints on private parties. Scholars talk about increasing social welfare,¹²² addressing the “tragedy of the commons,”¹²³ reallocating benefits and

(2001); U.S. DEP’T OF THE TREASURY, THE PROBLEM OF CORPORATE TAX SHELTERS: DISCUSSION, ANALYSIS AND LEGISLATIVE PROPOSALS 5 (1999). In contrast, structured-finance opinions generally facilitate legitimate commercial transactions. *See supra* note 32 and accompanying text.

¹¹⁶ *See supra* note 56 and accompanying text (observing that third-party opinion recipients ordinarily are involved in negotiating those opinions).

¹¹⁷ *See supra* note 37 (defining externalities as infringement of rights of non-contracting parties). In the context of structured-finance opinions, for example, the third parties affected by externalities are investors in the originator; such investors are not contracting parties vis-à-vis the structured-finance transaction or related opinions.

¹¹⁸ *See supra* note 28 and accompanying text.

¹¹⁹ *See supra* note 23 and accompanying text.

¹²⁰ *See supra* note 32 and accompanying text.

¹²¹ For example, it is implicit in the concepts of paternalism and externalities that only “wrongful” actions are protected against; but government itself, based at least in part on morals and norms, determines what is wrongful. It is also implicit in the concept of market efficiency, as another example, that externalities are minimized. JOSEPH STIGLITZ, *ECONOMICS* 179 (1993) (“With externalities present, the market’s allocation of goods is inefficient. . . . If firms do not have to pay all of the costs . . . equilibrium prices will be lower and output higher than they would be if firms took social costs into account.”).

¹²² Louis Kaplow & Steven Shavell, *Fairness versus Welfare*, 114 HARV. L. REV. 961, 967 (2001) (“Our central claim is that the welfare-based normative approach should be exclusively employed in evaluating legal rules. That is, legal rules should be selected entirely with respect to their effects on the well-being of individuals in society.”). *Cf.* RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 25 (6th ed. 2003) (explain the common law as a “system for maximizing the wealth of society”).

¹²³ The term comes from a 1968 article by Garrett Hardin, *The Tragedy of the Commons*, 162 SCIENCE 1243 (1968). A tragedy of the commons occurs when several independent persons all use a common and diminishable resource and their aggregate use threatens the sustainability of that resource. Baylor L. Johnson, *Ethical Obligations in a tragedy of the Commons*, 12 ENVIRONMENTAL VALUES 271, 273 (2003) (citing Hardin).

achieving allocative fairness,¹²⁴ maintaining norms and morals,¹²⁵ preserving and enhancing the efficiency of markets,¹²⁶ protecting parties from their own actions (paternalism),¹²⁷ and protecting parties from externalities.¹²⁸

Most of these reasons for imposing constraints do not appear to apply to structured-finance opinions. Except to the extent already bound up with “market efficiency” or “externalities,”¹²⁹ such opinions are unlikely to impact social welfare, problems of the “common,” allocative fairness, morals, or norms. Paternalism also should not be a basis for imposing constraints because structured-finance opinions are invariably issued in a sophisticated business and finance context.

Market efficiency clearly applies to structured-finance opinions. It should not, however, justify constraints because these opinions help to facilitate structured-finance transactions, which themselves are efficient.¹³⁰ Moreover, these opinions facilitate structured-finance transactions in an efficient way: by targeting the precise two elements of information asymmetry of concern to investors.¹³¹

The principal basis for government to impose constraints on structured-finance opinions therefore appears to be to protect against externalities.¹³² Constraints then could be couched as law or, where used to constrain lawyer behavior per se, as ethical rules.¹³³ Because this article’s

¹²⁴ Kaplow & Shavell, *Fairness versus Welfare*, *supra* note 122, at 999-1004.

¹²⁵ See, e.g., Thomas W. Merrill, *The Common Law Powers of Federal Courts*, 52 U. CHI. L. REV. 1, 69 (1985).

¹²⁶ POSNER, *ECONOMIC ANALYSIS OF LAW*, *supra* note 122, at 457. See also Ronald J. Gilson & Reiner H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 549-550 (1984) (claiming that the “efficient market hypothesis” has become the dominant context “in which serious discussion about the regulation of the financial markets take place”).

¹²⁷ See, e.g., Thaddeus Pope, *Counting the Dragon’s Teeth and Claws: The Definition of Hard Paternalism*, 20 GA. ST. U.L. REV. 659, 660 (2004) (defining paternalism as “the restriction of a subject’s self-regarding behavior primarily for the good of that same subject”).

¹²⁸ See, e.g., ALAN STONE, *REGULATION AND ITS ALTERNATIVES* 63, 91-123 (1982). See also *supra* note 37 (defining externalities). Protecting against externalities long has been a primary goal of government. See, e.g., Talmud, Tractate Pirke Avos, ch III., Mishnah 2 (instructing Jews to “[p]ray for the welfare of the government, for without fear of it people would swallow each other alive.”).

¹²⁹ See *supra* notes 126 and 128 and accompanying text. I recognize, *supra* note 121, that these terms have overlapping meanings.

¹³⁰ See *supra* note 32 (observing that securitization, the dominant form of structured-finance transaction, is efficient, fair, and economically desirable).

¹³¹ See *supra* note 75 and accompanying text (observing that investors in the SPV’s securities require a true sale of receivables to the SPV and protection of the SPV from the originator’s bankruptcy). I also later show that any information failure resulting from structured-finance transactions is caused not by these opinions but by independent investor failures. See *infra* notes 160-169 and accompanying text.

¹³² Recall that these externalities do not actually affect the opinion-recipient—the SPV and its investors—but, instead, affect the originator’s investors. See *supra* notes 38-39 and accompanying text.

¹³³ Ethical rules derive from a subset of the above-listed reasons for governmental constraints, with paternalism and minimizing externalities being the most prevalent. See Benjamin H. Barton, *Why Do We Regulate Lawyers?: An Economic Analysis of the Justifications for Entry and Conduct Regulation*, 33 ARIZ. ST. L. J. 429, 433, 436, 467-475 (2001) (arguing that the two most prevalent justifications for

analysis does not depend on the form in which the constraints are couched,¹³⁴ I will use the term “lawful” to refer to externalities whose causation is neither illegal nor government-constrained as unethical (the term “unlawful” consequently referencing externalities whose causation is either illegal or government-constrained as unethical).¹³⁵

I next focus on the extent to which externalities justify governmental constraints, and how those constraints should be applied. Before doing so, however, it is important to distinguish opinion-giving from the traditional role of lawyer as advocate. The differences necessarily cause different externalities, explaining why scholarship on lawyers’ duties within the adversary legal system is mostly inapplicable to the duties of lawyers issuing structured-finance opinions.¹³⁶ Traditional lawyering—which focuses on courtroom and client advocacy in an adversary system—can facilitate externalities, and there is a significant literature on the appropriate constraints to mitigate these externalities.¹³⁷ Subject to those constraints, society accepts the system of traditional legal advocacy.¹³⁸

regulating the legal profession are consumer protection and minimizing externalities to adversaries, the court system, and the public at large (the last being referred to herein as “public externalities”). Although there are other reasons for ethical rules (*cf.* Sean Griffith, *Ethical Rules and Collective Action: An Economic Analysis of Legal Ethics*, 63 U. PITT. L. REV. 347, 350 (2002) (arguing that legal ethics are a response to the collective action problems and public criticism lawyers face, and exist for the collective interest of the bar)), those other reasons are irrelevant to structured-finance opinions *per se*.

¹³⁴ This article need not differentiate, for example, between forms of governmental constraints, such as civil liability, criminal liability, or suspension or termination of the license to practice law. As used herein, the term “liability” includes all these forms of constraints.

¹³⁵ By government-constrained, I include ethical rules promulgated by non-governmental bodies, such as the American Bar Association, but enforced by government power. In practice, constraints on public externalities caused by structured-finance opinions are more likely to be couched as law. *Cf. Barton, Why Do We Regulate Lawyers?*, *supra* note 133, at 475 (arguing that the rules of professional conduct for lawyers do not effectively correct public externalities, and observing that most ethical rules that “even arguably address those externalities” are hortatory). To the extent feasible, of course, lawyers should strive also to meet aspirational goals for conduct. *Cf. infra* note 250 and accompanying text.

¹³⁶ *Cf.* MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 7-3, EC 7-4 (1969) (distinguishing between a lawyer’s role as advocate and counselor). Professor Gordon similarly makes a distinction between the lawyer as advocate and the lawyer as corporate counselor. Gordon, *A New Role for Lawyers?*, *supra* note 82, at 1194-95.

¹³⁷ *See, e.g.,* Robert Burns, *Professional Responsibility in the Trial Court*, 44 S. TEX. L. REV. 81 (2002) (arguing that current ethical restraints on trial lawyers represent an important contribution to the fairness and effectiveness of the adversary system, but cautioning that certain ethical tensions between complete candor and client advocacy are inherent in that system and that the effects of further ethical requirements must be carefully considered before enacting them); Gary Hoffman & Lauren Degan, *Responding to Hardball Tactics and Questionable Tactics in Litigation: Limits on Advocacy*, 10 NO. 3 INSIDE LITIG. 7 (1996) (noting the limits legal ethics place on an attorney’s behavior as a client advocate).

¹³⁸ *See, e.g.,* Robert Gilbert Johnston and Sara Lufrano, *The Adversary System as a Means of Seeking Truth and Justice*, 35 J. MARSHALL L. REV. 147, 154, 160-161 (2002) (arguing that the adversary system of litigation as tempered by the Model Rules of Professional Conduct is an effective and superior mechanism for obtaining truth and justice). *Cf.* Fred C. Zacharias, *The Future Structure And Regulation of Law Practice: Confronting Lies, Fictions, And False Paradigms in Legal Ethics Regulations*, 44 ARIZ. L. REV. 829, 855 (2002) (noting that “with little exception” the Model Rules rely on the adversary paradigm, but arguing that even where the legal practice takes place within the adversary system “the premises the code drafters attribute to the adversary paradigm do not hold true”). My observation is descriptive, not normative. I do not purport to critique the constraints on externalities resulting from traditional legal advocacy.

Opinion-giving also can facilitate externalities. But there is little learning on the appropriate constraints because these externalities are different from those of traditional lawyering. To understand why there are differences, consider how a lawyer’s traditional advocacy role differs from the role of counsel in issuing opinions. One distinction is that, in the traditional role, there is invariably counsel on the other side to balance the argument and thereby arguably mitigate externalities. This is not to say that this difference is black and white. Counsel providing third-party legal opinions—the type of opinion comprising virtually all structured-finance opinions¹³⁹—often have to negotiate their opinion with counsel for the opinion recipient.¹⁴⁰

The second distinction is more clear-cut, however. Advocacy demands unusually creative lawyering. Where a lawyer advocates for a client, the lawyer’s duty is to help the client win by creatively arguing that the client has complied with law or has a stronger case than the opposing party.¹⁴¹ There are, of course, ethical constraints on the limits of advocacy,¹⁴² but—subject to those constraints—creativity is respected and valued.¹⁴³ Likewise, where the lawyer advocates for a client in a negotiation, the lawyer’s duty is to help the client reach the best deal possible by creatively arguing the merits of the client’s position.¹⁴⁴

This perspective—that traditional lawyering is all about advocacy, and thus creativity—helps further explain why the well-known decision in *U.S. v. Simon*¹⁴⁵ has not been extended to lawyers, at least in their traditional advocacy roles. In that case, the court upheld jury instructions that an accountant can be liable, even though the accountant complied with both GAAP and generally accepted auditing standards, if certified financial statements do not “fairly present” the company’s financial condition and results of operations.¹⁴⁶ This decision reflects that an accountant’s goal in auditing a company and certifying the accuracy of its financial statements is

¹³⁹ See *supra* notes 52-54 and accompanying text.

¹⁴⁰ Leslia L. Gardner, *Attorney Liability to Third Parties for Corporate Opinion Letters*, 64 B.U.L. REV. 415, 419 n.34 (1984) (“the general content of the legal opinion is usually negotiated prior to its issuance”). See also *Guidelines for the Preparation of Closing Opinions*, *supra* note 55, §§ 2.1–2.2 at 877 (outlining the negotiating process between opposing lawyers to determine the final form of the opinions); TriBar 1998 Report, *supra* note 56, § 1.3 at 599–600 (explaining that all transactions are unique and as such require a certain amount of negotiation between opinion-givers and opinion-recipients).

¹⁴¹ See, e.g., *In re American Fin. Co.*, 40 S.E.C. 1043, 1049 (1962) (in which the SEC noted that an attorney, although “owing a public responsibility,” at least where acting as the “client’s advisor, defender, advocate and confidant . . . enters into a personal relationship in which his principal concern is with the interests and rights of his client”).

¹⁴² See, e.g., *Barton, Why Do We Regulate Lawyers?*, *supra* note 133, at 471 & 473 (discussing those constraints); *Griffith, Ethical Rules and Collective Action*, *supra* note 133 at 375-387 (same).

¹⁴³ *But cf.* Gordon, *A New Role for Lawyers?*, *supra* note 82, at 1204-07 (arguing that a corporate lawyer’s loyalty should run to the public as well as the client even in an adversary proceeding because the lawyer’s role “is in large part a public role, designed to fulfill public purposes” (such as, *id.* at 1206, arguing to suppress unlawfully-seized evidence and thereby deterring police misconduct, and advancing one-sided selective arguments to keep prosecutors “up to the mark”).

¹⁴⁴ *In re American Fin. Co.*, *supra* note 141.

¹⁴⁵ 425 F.2d 796 (2d Cir. 1969).

¹⁴⁶ *Id.* at 805-06 (affirming the trial judge’s decision that compliance with GAAP could not constitute a complete defense—“the ‘critical test’ was whether the financial statements as a whole ‘fairly presented the financial position of [the Company]’”).

fair and objective presentation of the company's financial state.¹⁴⁷ Few if any would say that goal is, or can be, achieved through the use of creative accounting.¹⁴⁸ Fair and objective presentation, however, is fundamentally different from the goals of traditional legal advocacy.

In contrast, an opining lawyer's goal—to accurately predict a given legal state by applying law to fact¹⁴⁹—is closer to accounting goals than to the goals of traditional legal advocacy. Technical accuracy must be valued more than creativity, and indeed creativity that undermines accuracy must be eschewed. These differences necessarily cause externalities *different from* those resulting from traditional legal advocacy, and thereby muddle the legal-opinion debate.

I next examine to what extent these different externalities justify legal or ethical constraints on structured-finance opinions.

Examination of externalities: By definition, externalities caused by structured-finance opinions affect the public, not the originator or the opinion-recipient.¹⁵⁰ For purposes of the analysis that follows, it is useful to divide these externalities into two categories: lawful externalities, and unlawful externalities.¹⁵¹

All transactions, including structured-finance transactions, create externalities.¹⁵² Therefore, any time a lawyer issues a legal opinion that effectuates a transaction, the lawyer is participating in creating externalities. The paradigm of social ordering, however, is that, left to independent bargaining, parties work out arrangements that—except to the extent the arrangements create unlawful externalities¹⁵³—overall benefit the public good.¹⁵⁴ To the extent

¹⁴⁷ See, e.g., American Institute of Certified Professional Accountants (AICPA) Code of Professional Conduct §§ 53.01 & 53.03 (emphasizing the accounting profession's dedication to "objectivity," "integrity," and "a genuine interest in serving the public"); § 51.02 (acknowledging "the [accounting] profession's recognition of its responsibilities to the *public*, to clients, and to colleagues") (emphasis added).

¹⁴⁸ But compare an accountant's more purely advocacy roles, such as helping a client minimize taxes. Here the accountant, like an attorney, values creativity, and the law respects that. Cf. *Chamberlain v. Commissioner*, 207 F.2d 462, 468 (6th Cir. 1953) ("The general principle is well settled that a taxpayer has the legal right to decrease the amount of what otherwise would be his taxes . . . and that the taxpayer's motive to avoid taxation will not establish liability if the transaction does not do so without it.").

¹⁴⁹ See *supra* notes 58 & 68 and accompanying text.

¹⁵⁰ Cf. *supra* notes 37 (defining externalities as harm to non-contracting parties) and 116 and accompanying text.

¹⁵¹ As defined *supra* note 135 and accompanying text.

¹⁵² Cf. STONE, REGULATION AND ITS ALTERNATIVES, *supra* note 128, at 97 (observing that "[s]trictly speaking, virtually every activity involves an externality").

¹⁵³ See *infra* note 155 and accompanying text (observing this limitation on the social-ordering paradigm).

¹⁵⁴ See, e.g., ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 477 & 477 n. 485 (E. Cannan ed. 1976): "As every individual, therefore, endeavours as much as he can both to employ his capital in the support of domestic industry, and so to direct that industry that its produce may be of the greatest value; every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it. By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he

lawyers facilitate these arrangements, they are working to enhance the public good. This suggests that lawyers should have the right to help facilitate lawful transactional arrangements by issuing legal opinions. A fortiori, they should have the right to help facilitate lawful structured-finance transactions by issuing structured-finance opinions.

In a business context, the primary limitation on the social-ordering paradigm is that the arrangements should not create externalities that society defines as unlawful.¹⁵⁵ Lawyers specifically help in this regard by advising clients on whether their arrangements are lawful. Lawyers therefore are social engineers, contributing to this social-ordering paradigm.¹⁵⁶

If lawyers were constrained from providing opinions to effectuate bargained-for lawful business transactions that nonetheless may cause externalities, they would be forced to substitute their judgment about externalities for that of their clients. From an information standpoint, however, clients generally have more and better information about the consequences of transactions, other than the transaction's legality. The clients therefore are better positioned to make business decisions. Imposing a duty on lawyers to second-guess their clients' business decisions would be inefficient.¹⁵⁷ This insight helps explain Congressional testimony on the role of lawyers in rendering legal opinions:

If a transaction is not illegal and has been approved by the appropriate levels of corporation's management, lawyers ... may appropriately provide the requisite legal

intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention." See also Michel Rosenfeld, *Contract and Justice: The Relationship Between Classical Contract Law and Social Contract Theory*, 70 IOWA L. REV. 769, 846-847 (1985) (arguing that the "fact that parties in pursuit of self-interest agree to an exchange indicates that the exchange in question is likely to enhance allocative efficiency. Furthermore, the fine tuning arising out of the bargaining process serves the common good by assuring that increased value is purchased at the lowest possible expense. Reciprocity, then, not only permits the alignment of individual self-interest and the common good, but it does so in a manner that (as we shall more fully see below) is very reminiscent of Adam Smith's 'invisible hand.'"); Posner, *Wealth Maximization and Judicial Decision-Making*, 4 INT'L REV. L. & ECON. 131, __ (1984).

¹⁵⁵ Persons injured by externalities that society does not define as unlawful sometimes have the right to recover damages from parties causing those externalities—thereby effectively shifting the externalities back onto those parties. See, e.g., POSNER, *ECONOMIC ANALYSIS OF LAW*, *supra* note 122, at 383-85 (discussing the optimal choice between "two methods of public control—the common law system of privately enforced rights [i.e., the right to recover damages from parties causing externalities] and the administrative system of direct public control"). Although this right to recover damages, where it exists, supplements the social-ordering paradigm, it does not alter this article's fundamental analysis because of its self-correcting nature (i.e., shifting externalities back onto the parties causing them).

¹⁵⁶ Cf. Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239 (1984) (describing lawyers as transaction-cost engineers, and describing how legal opinions can reduce information-asymmetry costs).

¹⁵⁷ See, e.g., Sean J. Griffith, *Afterward and Comment: Towards an Ethical Duty to Market Investors*, 35 CONN. L. REV. 1223, 1234 n. 43 (2003) (cautioning that "[v]aguely defined duties to 'the public' threaten to increase the agency costs of the legal representation as lawyers may seek to pursue their own ideological goals in favor of client interests"); James A. Cohen, *Lawyer Role, Agency Law, and the Characterization "Officer of the Court,"* 48 BUFF. L. REV. 349, 387-88 (2000) (cautioning against "[c]laims that lawyers should be free to disobey the client's lawful instructions").

advice and opinions about legal issues relating to the transactions [sic]. In doing so, the lawyers are not approving of the business decisions that were made by their clients.¹⁵⁸

Indeed, it is hard to see exactly how lawyers could be constrained from providing opinions on transactions that create lawful externalities. Lawyers, who are specialists only in law, would be ill-trained to assess and weigh the costs (including externalities) and benefits of business transactions being facilitated by their opinions. How, for example, would counsel asked to opine on a proposed break-up leveraged buyout¹⁵⁹ balance costs and benefits where the resulting transaction creates a more efficient business but, in the process, costs 1,000 jobs, impoverishes a community, and destroys families? Constraining lawyers from opining on lawful transactions that nonetheless may cause externalities would appear to be unworkable in practice.

The social-ordering paradigm would be undermined, nonetheless, to the extent expert advisors, such as lawyers and accountants, provide inaccurate information that distorts transactional arrangements. This distortion could be especially significant in a structured-finance transactional context, where legal opinions and accounting disclosures are so vital a part of the information flow. And admittedly, sometimes, there is an information failure: the “masking” of liabilities that only first become evident when a company goes bankrupt.¹⁶⁰

This information failure, however, is generally not the result of inaccurate information provided by lawyers,¹⁶¹ nor is it likely the result of inaccurate information provided by accountants. Although this information failure might be exacerbated by a dual-information problem—legal-opinion information is accurately provided for one purpose, bankruptcy, but then used somewhat out of context for another purpose, accounting¹⁶²—it does not primarily result from that dichotomy. The underlying rationale behind off-balance sheet accounting is consistent with the bankruptcy opinion: that the financial assets in question have been sold.¹⁶³ GAAP views the bankruptcy opinion as merely a convenient indicator of the sale.¹⁶⁴

The real information failure is occasional investor failure to understand, much less appreciate, underlying disclosure concerning structured-finance transactions. This can occur for at least two reasons. One is that investors—even sophisticated investors—do not always carefully review the disclosure. They often focus, for example, exclusively on a company’s balance sheet without regard to contingent risks disclosed in the footnotes¹⁶⁵ and offering documents.¹⁶⁶

¹⁵⁸ Hearing Before the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce, 107th Cong. 19-22, 20 (2002) (statement of Joseph C. Dilg, Managing Partner, Vinson & Elkins).

¹⁵⁹ For a discussion of fraudulent conveyance law in the LBO context and the no-fraudulent-conveyance opinions required as a condition to funding, *see generally* Raymond J. Blackwood, *Applying Fraudulent Conveyance Law to Leveraged Buyouts*, 42 DUKE L.J. 340 (1992); Douglas G. Baird & Thomas H. Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 VAND. L. REV. 829, 850-54 (1985).

¹⁶⁰ *See supra* notes 13-20 and accompanying text.

¹⁶¹ *See supra* note 28 and accompanying text (observing that structured-finance opinions typically are accurate regarding the legal matters they purport to cover).

¹⁶² *See supra* notes 7-11 and accompanying text.

¹⁶³ *See* FAS 140 ¶ 27.

¹⁶⁴ *Id.*

¹⁶⁵ *See supra* note 19 and accompanying text.

Although some investors might fail to focus on these risks due to laziness, the more likely explanation for the failure is a fundamental lack of comprehension that these risks can be significant, resulting from a misunderstanding of the necessary and significant role of contingent recourse in the sale of the financial assets. Because of information asymmetries between sellers (in the structured-finance context, originators) and buyers (in the structured-finance context, SPVs), a buyer of financial assets¹⁶⁷ always must demand, to the extent consistent with a true sale, some amount of contingent recourse against the seller.¹⁶⁸ This recourse is a necessary solution to the problem of quality uncertainty.¹⁶⁹

There is no question that this recourse must be disclosed. Law and accounting standards have long required disclosure of all realistic liabilities, including contingent recourse,¹⁷⁰ and even “reasonably possible” contingent liabilities must be disclosed in the footnotes to the originator’s balance sheet.¹⁷¹ Investors, however, generally tend to be familiar with ordinary sales of tangible assets, in which contingent recourse, when it exists, is typically limited to standard warranties. They therefore do not always comprehend that a sale might expose the seller to this greater level of contingent recourse. The obvious solution to this failure is to educate investors to carefully read and understand the disclosure, including footnotes to financial statements, to ascertain and assess the possible contingent recourse.¹⁷² To some extent, this education is already ongoing.¹⁷³

¹⁶⁶ Offering documents, such as prospectuses, independently must disclose any material risks in order to comply with SEC Rule 10b-5 (17 CFR §240.10b-5). Cf. Cunningham, *Sharing Accounting’s Burdens*, *supra* note 111, at 1454: “For any business transaction, there is an accounting consequence and in turn or simultaneously a disclosure consequence. They are related.”

¹⁶⁷ Recall that structured-finance transactions involve the sale of financial assets. *See supra* note 43.

¹⁶⁸ *See, e.g., Enron and the Use and Abuse of Special Purpose Entities in Corporate Structures*, *supra* note 12, at 1316 n. 38 (observing that “although securitization deals do shift actual risk, they always require the company originating the deal [the originator] to retain sufficient first-loss risk on the transferred assets . . . to minimize the [SPV] investor risk to an investment grade level. . . . [This recourse] logically follows from the asymmetric information between the [originator] and the SP[V]’s investors.”); Peter C. Pantaleo *et al.*, *Rethinking the Role of Recourse in the Sale of Financial Assets*, 52 *BUS. LAW.* 159 (1996) (discussing the importance of contingent recourse in the sale of intangible assets).

¹⁶⁹ George A. Akerlof, *The Market for “Lemons”: Quality Uncertainty and the Market Mechanism*, 84 *Q.J. ECON.* 488, 499 (1970) (referring to guaranties, which include what my article terms recourse). Although Akerlof suggested other potential solutions to the problem of quality uncertainty, only guaranties, or recourse, applies to the fact scenario of this article.

¹⁷⁰ *See supra* note 18 and accompanying text.

¹⁷¹ *Id.*

¹⁷² Ascertaining the amount of contingent recourse and the likelihood it will be asserted is not a trivial task. *See supra* note 20 (examining whether contingent recourse could be disclosed more prominently than in footnotes, perhaps even as a separate accounting category, but concluding that such disclosure would remove the filter of an accountant making an informed assessment of the transaction and associated recourse, resulting in an information dump that would make it harder, not easier, for investors to make informed investment decisions; and also concluding that if merely the existence of contingent recourse were prominently disclosed, investors would have insufficient information to assess the risk, often misleading investors into believing that the company is riskier than it really is).

¹⁷³ *See supra* note 17 (observing that, post-Enron, investors have been widely educated to carefully review financial-statement footnotes as part of their investment or credit decisions).

The second reason that investors occasionally fail to understand and appreciate underlying disclosure is that some structured-finance and other business transactions are so complex that disclosure is necessarily imperfect—either oversimplifying the transaction, or providing detail and sophistication beyond the level of even most sophisticated investors and securities analysts.¹⁷⁴ In the latter case, even if investors and analysts considered hiring teams of experts, information asymmetries would remain.¹⁷⁵ That does not necessarily mean that government should ban these transactions.¹⁷⁶ There are, for example, other solutions: in addition to disclosure, for example, require management to be free of material conflicts of interest stemming from complex transactions for which disclosure may be insufficient.¹⁷⁷ The rationale for this solution is that, in the face of complexity, investors must rely not only on disclosure but also on the business judgment of management in setting up complex transactions for the company's benefit.¹⁷⁸ To that end, the law similarly should focus, in addition to disclosure, on requiring management to be free of conflicts of interest that would affect management's judgment in those transactions.¹⁷⁹ This focus would have prevented the conflicts of interest that allowed, and indeed encouraged, the Enron abuses to thrive.¹⁸⁰

The foregoing analysis shows that the real information failure in structured-finance transactions is unrelated to legal opinions *per se*, and has solutions that are likewise unrelated. Although the information failure is indirectly related to structured-finance opinions—insofar as such opinions facilitate structured-finance transactions, which can cause information failure—the solutions discussed above appear preferable to proscribing structured-finance transactions (and thus proscribing the issuance of structured-finance opinions) as a means of mitigating the

¹⁷⁴ See generally *Rethinking the Disclosure Paradigm in a World of Complexity*, *supra* note 20.

¹⁷⁵ *Id.* at 13-16 (explaining why institutional investors and securities analysts do not always fully understand disclosure of complex transactions). To summarize this explanation, at some level of complexity the costs of hiring experts will exceed, or at least appear to exceed, any potential gain because the cost of hiring experts is tangible, whereas the benefit gained from fully understanding complex transactions is intangible and harder to quantify. The more complex the transaction, the higher the costs, and thus the more likely it is that the cost-benefit balance will be out of equilibrium. Furthermore, market imperfections reduce the value of hiring expert analysts. Scholars have found, for example, that investment-fund managers who, believing a stock is overvalued, nonetheless follow the crowd will not be blamed if the stock ultimately crashes. This imperfection is exacerbated by the typically limited time horizon of analyst employment; the analyst may no longer be at the same job if and when a crash occurs, so accountability may be low to begin with. On the flip side, even where analysts remain at the same job, they may lose their expertise over time: they presumably were hired because of their structured-transaction expertise; but structured-transaction markets evolve and, as analysts, they would no longer be employed doing market deals. Moreover, these market imperfections are consistent with the results that would be predicted by behavioral psychology. There also are practical limitations on understanding complexity. The complexity problem affects investors in the originator's securities, yet those investors are not necessarily the same institutions that participate in structured transactions—and thus are less capable of understanding the complexity. Even where they are the same institutions, the analysts reviewing the disclosure will not likely be, and may be prohibited from being, the structured-transaction specialists.

¹⁷⁶ See *id.* at 21-23 (examining the consequences of proscribing complex transactions that result in significant information asymmetry, and concluding that regulators should not want to proscribe these transactions as a means of controlling information failure).

¹⁷⁷ *Id.* at 31-32 & 35-36 (discussing this “second-best” solution).

¹⁷⁸ *Id.* at 36-37.

¹⁷⁹ *Id.*

¹⁸⁰ *Id.* at 37.

information failure.¹⁸¹ The information failure therefore should not affect this article’s normative argument: that where lawyers facilitate lawful transactions that create problematic externalities, the focus should be not on lawyer conduct but instead on whether to legally prohibit those transactions—or at least subject the companies that engage in them to liability in order to shift the externalities back onto those companies.¹⁸² To the extent these transactions are lawful, lawyers should indeed have the right¹⁸³ to “assist corporate managers to inflict enormous damage and then argue ... that they are only doing the job they are supposed to do.”¹⁸⁴ Under the social-ordering paradigm,¹⁸⁵ lawyers acting in this fashion will, overall, benefit the social good.¹⁸⁶

The foundation of this article’s framework, therefore, is that lawyers should have the right to issue opinions that help facilitate lawful structured-finance transactions.¹⁸⁷ Completing the framework, though, requires resolving two ancillary issues: in assessing lawfulness, should attorneys examine the entire transaction or just the portion thereof relating to the opinion; and what should lawfulness mean in a world of changing norms? I address these issues below.

In assessing lawfulness, should attorneys examine the entire transaction or just the portion thereof relating to the opinion?: In a perfect universe, attorneys should examine an entire transaction to ensure that their opinion does not inadvertently help facilitate unlawful transactions. Our universe, though, is imperfect—it has costs. From a cost-benefit standpoint, reviewing an entire transaction, where only a portion need be examined to render an opinion, does not appear warranted. For this reason, a lawyer retained by an originator solely to provide a structured-finance opinion would not be expected to assess the transaction’s overall legality, and certainly would not be paid for work performed in making that assessment.¹⁸⁸ As a practical matter, moreover, as outside lawyers specialize further and companies bring even more of their day-to-day work in-house, it is increasingly likely that counsel retained to provide third-party

¹⁸¹ See *supra* note 32 and accompanying text (showing that securitization, the dominant form of structured-finance transaction, is efficient, fair, and economically desirable). See also *supra* note 176 and *Rethinking the Disclosure Paradigm in a World of Complexity*, *supra* note 20, at 21-23 (showing why regulators should not want to proscribe structured-finance transactions as a means of controlling information failure).

¹⁸² See *supra* note 155.

¹⁸³ That right being subject, of course, to the overriding right of a lawyer to resign if he or she believes the representation is immoral or improper.

¹⁸⁴ Gordon, *A New Role for Lawyers?*, *supra* note 82, at 1190 (arguing that this is problematic).

¹⁸⁵ See *supra* note 154 and accompanying text (describing this paradigm).

¹⁸⁶ [Consider also the extent to which lawyers’ opinion letters, especially in public-law fields, is essentially private ordering (*cf.* Schwarcz, *Private Ordering*, *supra* note 41), and whether the literature on private ordering adds to or informs the foregoing normative framework. *Cf.* Freeman, *Opinion Letters and Professionalism*, *supra* note 29, at 377 (observing that “[t]here is inherent in the idea of the lawyer’s being favored with a monopoly license to practice law the premise that his performance as a professional will be subjected to self-regulation by the lawyer himself and to more formal regulation by the profession as a whole”). A private-ordering perspective could be particularly relevant to structured-finance opinions because accounting is an explicitly delegated form of private ordering, in which the Financial Accounting Standards Board (FASB) effectively acts as an agent of the SEC and individual accountants effectively act as sub-agents. Schwarcz, *Private Ordering*, *supra* note 41, at notes 41-42 and accompanying text and at 320 n.8.]

¹⁸⁷ Again, lawfulness being defined *supra* note 135 and accompanying text.

¹⁸⁸ E-mail from Edward M. De Sear, *supra* note 22.

legal opinions will see only those aspects of the transaction relevant to counsel's opinion, not the entire transaction.

There are at least two ways to curtail externalities without necessarily requiring counsel to examine the entire transaction. A minimalist approach, proposed earlier in this article,¹⁸⁹ is to permit counsel to assume legality if the portion of the transaction relevant to their opinion is lawful and, in the course of preparing due diligence for their opinion, such counsel do not spot warning signs putting them on notice of problems. Where, however, counsel do spot warning signs, they should investigate further before issuing their opinion.¹⁹⁰ The logic of this approach is its pragmatic balancing of costs and benefits.

In that context, not only the scope but also the purpose of any such investigation should be limited. Opining counsel cannot feasibly investigate for fraud in the sense that a district attorney would investigate. That investigation—normally be performed by litigators—would be time-consuming and expensive, and no client would pay for its cost. Rather, opining counsel should investigate sufficiently to see if the warning sign, which may well be ambiguous, can be dispelled and the requested opinion given. If the warning sign cannot be dispelled, or if other warning signs emerge, the lawyer should decline to give the opinion and, in appropriate circumstances, withdraw from the representation.¹⁹¹ Whether the lawyer also should have some duty to inform government regulators is beyond the scope of this article.¹⁹²

This approach is tied, of course, to the need to define what constitutes warning signs.¹⁹³ It would be too limiting for this article, in a vacuum of fact, to attempt to supply that definition. Because warning signs are more easily recognized than defined, the definition should develop on a case-by-case basis.¹⁹⁴ For example, a refusal by in-house counsel to issue a requested no-violation-of-law opinion¹⁹⁵ certainly should constitute a warning sign. So too should opining

¹⁸⁹ See *supra* notes 101-104 and accompanying text (proposing this approach).

¹⁹⁰ *Id.*

¹⁹¹ Cf. Small, *An Attorney's Responsibilities Under Federal and State Securities Laws*, *supra* note 80, at 1199 (arguing that when an attorney is “on notice of facts which, if inquired into, would disclose that he could not render an opinion, he may be guilty of such recklessness that his activities [in rendering a legal opinion] should be proscribed even if he was not a conscious or knowing participant in a violation of law”); Coffee, *The Attorney as Gatekeeper*, *supra* note 88, at 1297 (arguing that securities lawyers should function as “gatekeepers”—a role borne by “independent professionals who are so positioned that, if they withhold their consent, approval, or rating, the corporation may be unable to effect some transaction or to maintain some desired status”—when they detect problems with a corporation’s securities disclosure).

¹⁹² Cf. Valerie Breslin & Jeff Dooley, *Whistle Blowing v. Confidentiality: Can Circumstances Mandate Attorneys to Expose Their Clients?*, 15 GEO. J. LEGAL ETHICS 719 (summer 2002) (outlining the controversy surrounding “noisy withdrawal” in the legal field).

¹⁹³ See *supra* notes 101-104 and accompanying text.

¹⁹⁴ This approach follows the judicial litmus test of “we know it when we see it.” *Jacobellis v. Ohio*, 378 U.S. 184, 197 (1964) (Stewart, J., concurring). The Supreme Court adopted such a test for adjudicating pornography cases. See *Miller v. California*, 413 U.S. 15, 24 (1973) (“whether ‘the average person, applying contemporary community standards’ would find that the work, taken as a whole, appeals to the prurient interest?”); *Roth v. United States*, 354 U.S. 476, 489 (1957).

¹⁹⁵ As discussed in the next paragraph.

counsel's being asked to make an apparently unreasonable assumption.¹⁹⁶ The existence of undisclosed side-agreements is another clear warning sign.¹⁹⁷ Although failure to see a business purpose in a transaction also might be a warning sign,¹⁹⁸ that devolves on what constitutes a business purpose. Raising financing or reducing its cost always should be good business purposes.¹⁹⁹ So too should shifting risk on assets to outside investors,²⁰⁰ or diversifying a company's funding sources.²⁰¹ Mitigating taxes often has been viewed as a legitimate business practice.²⁰² Although more debatable, it even can be argued that achieving an accounting treatment permitted by GAAP is, in and of itself, a legitimate business purpose.²⁰³ Courts also should exercise caution against finding warning signs where none exist. Thus, as previously discussed,²⁰⁴ the fact that a structured-finance transaction has loan-like economics should not, in and of itself, constitute a warning sign.

Another approach that curtails externalities without requiring counsel issuing the structured-finance opinion to examine the entire transaction is to supplement the minimalist approach by an additional requirement: such counsel should obtain, in appropriate cases as part of their due diligence, an opinion from other counsel to the originator—typically in-house counsel—that the overall transaction does not violate law (a “no-violation-of-law” opinion).²⁰⁵ Thus, structured-finance counsel may assume legality if the portion of the transaction relevant to their opinion is lawful, they obtain a no-violation-of-law opinion from in-house counsel, and (in the course of preparing the remaining due diligence for their opinion) they do not spot warning signs putting them on notice of problems. Where they do spot warning signs, they should investigate further before issuing their opinion.

¹⁹⁶ Cf. *U.S. v. Simon*, *supra* note 145, at 806-07 (holding that once an accountant has reason to believe that a basic assumption is false, the accountant must “extend his procedures to determine whether or not [his] suspicions are justified”).

¹⁹⁷ See, e.g., Report of Investigation by the Special Investigative Committee of the Board of Directors of Enron Corp. [William C. Powers, Jr., Chair] at 41-42, 49-50, 52 (Feb. 1, 2002) (observing that the financing structure Enron Corp. created for the Chewco SPV was at least 50% short of the required third-party equity need for accounting non-consolidation because a portion of such equity was protected by undisclosed reserve accounts funded by Enron).

¹⁹⁸ See, e.g., Richard Acello, *Enron Lawyers in the Hot Seat*, 90 ABA J. 22 (June 2004) (quoting Shaun Martin, legal ethics professor at University of San Diego, as stating: “If a lawyer can’t come up with a good business reason for what she is doing, the lesson [of Enron] is to think twice about it.”).

¹⁹⁹ *Enron and the Use and Abuse of Special Purpose Entities in Corporate Structures*, *supra* note 12, at 1315.

²⁰⁰ *Id.*

²⁰¹ *The Alchemy of Asset Securitization*, *supra* note 12, at 143.

²⁰² *Chamberlain v. Commissioner*, *supra* note 115.

²⁰³ Cf. *Enron and the Use and Abuse of Special Purpose Entities in Corporate Structures*, *supra* note 12, at 1315 (differentiating securitization used to keep debts off a company’s balance sheet from some of Enron’s uses of SPVs).

²⁰⁴ See *supra* notes 91-92 and accompanying text.

²⁰⁵ Cf. Silverado Report, *supra* note 55, at 2, 34-37 (defining and commenting on the scope of this opinion). In appropriate cases, opining counsel also might want to ask for a “due authorization” opinion—that the transaction in question has been duly authorized. See TriBar Committees, *Legal Opinions to Third Parties: An Easier Path*, *supra* note 47, at 1912-14.

This article is agnostic as to whether the minimalist approach always should be supplemented through a no-violation-of-law opinion. Requiring such an opinion, even from in-house counsel, can be costly²⁰⁶ and would not be a panacea.²⁰⁷ Imposing such a requirement also would be inconsistent to some extent with the existing norm that companies have no *de novo* obligation to retain counsel when engaging in business transactions.²⁰⁸ Even absent that requirement, however, structured-finance counsel sometimes may want the additional assurance provided by requesting a no-violation-of-law opinion.

Irrespective of the approach selected, transactions that are lawful today sometimes might be suspect tomorrow. I next examine what lawfulness means in a world of changing laws and norms.

What should lawfulness mean in a world of changing laws and norms?: Lawfulness ultimately derives from a society's norms, and norms change in response to changing conditions. Where positive law reflects existing norms, lawfulness should be clear. But where there are disconnects between positive law and norms, or disconnects between the positive law applicable at the time an opinion is given and the time of an adjudication (hereinafter, disconnects over time), lawfulness may be ambiguous.

Disconnects between positive law and norms can occur in two ways: at the time an opinion is given, the transaction (or portion thereof that should be examined) complies with (i) positive law but not norms, or (ii) norms but not positive law.²⁰⁹ In case (i), lawyers theoretically

²⁰⁶ See GLAZER AND FITZGIBBON ON LEGAL OPINIONS, *supra* note 49, § 13.2.1 at 450 (noting that to issue a thorough no-violation-of-law opinion would take “weeks of work by a legion of lawyers”).

²⁰⁷ At least under today's customary practice (as codified in ABA guidelines), no-violation-of-law opinions are viewed as covering only “law . . . that, given the nature of the transaction and the parties to it, a lawyer in the relevant jurisdiction exercising customary diligence would reasonably recognize as being applicable.” TriBar 1998 Report, *supra* note 56, § 6.6 at 662. Furthermore, unless explicitly agreed, these opinions are viewed (again, under today's customary practice as codified in ABA guidelines) as excluding examination of certain laws that may be clearly applicable. GLAZER AND FITZGIBBON ON LEGAL OPINIONS, *supra* note 49, § 13.2.2.7 at 457–58 (observing that the antitrust, securities, insolvency, and tax laws are ordinarily deemed excluded from examination unless explicitly addressed). Although delivery of a no-violation-of-law opinion might well imply that opining counsel is unaware of other legal problems (including problems in the excluded areas of law), some might argue that any such inference is inappropriate in the absence of due diligence. See Telephone interview with Donald W. Glazer (June 20, 2005) (observing that lawyers cannot make responsible judgments, even regarding negative assurance, without going through some process of diligence). Cf. Special Report of the Task Force on Securities Law Opinions, ABA Section of Business Law, *Negative Assurance in Securities Offerings*, 59 BUS. LAW. 1513, 1515 (2004) (observing that “[l]awyers customarily provide negative assurance in connection with [securities] offerings based on their review, within the limited time available, of the offering documents and the documents incorporated by reference, as supplemented by their knowledge of the Company's affairs gained in prior representation”).

²⁰⁸ See *supra* note 103 and accompanying text.

²⁰⁹ The remaining permutations occur where, at the time the opinion is given, the transaction complies with (iii) both norms and positive law, or (iv) neither norms nor positive law. Where a transaction complies with neither norms nor positive law, it is patently unlawful; lawyers then should have no right to help facilitate it (by issuing opinions or otherwise). Where a transaction complies with both norms and positive law, it might appear that lawyers have a clear right to facilitate it. Even then, however, I show that lawyers may be criticized and, wrongly, subjected to liability. See *infra* notes 226–240 and accompanying text (discussing retroactive application of law).

should have the right to issue opinions that help facilitate those transactions. The rationale is that lawyers and opinion-recipients must rely on objective standards, and the existence of positive law is such a standard.²¹⁰ Norms, in contrast, represent what the law should be, which is often unsettled if not controversial. This article, for example, makes normative claims with which, I anticipate, some may disagree.

In practice, though, it is risky to issue opinions to help facilitate transactions that violate norms. Even where those norms are not yet incorporated into positive law, issuing these opinions just looks bad. That, in turn, can lead to reputational loss—such as when the transaction is taken up before some Congressional committee or in the press as the poster child for why the law should be changed. Issuing these opinions also may tempt some judges, where the public suffers losses, to apply a flawed syllogism: the public is harmed; these opinions are a *sine qua non* of the harm, and lawyers are the only deep pockets²¹¹; therefore lawyers should be liable for the harm. Issuing opinions to help facilitate transactions that violate norms, even where lawful, is unwise.

Turning now to the second disconnect, lawyers clearly should have no right to render opinions that help facilitate transactions that comply with norms but not positive law. The rationale is, again, that lawyers and opinion-recipients must rely on objective standards.²¹² Positive law provides such a standard, norms do not. Thus, even though the legal and ethical constraints that allowed the opinions in Enron reflected the norms of that time—an “adversary stance of companies toward regulation and regulators,”²¹³ the increased competition among law firms for client business,²¹⁴ and the then-dominance of “the cults of market economism and shareholder-wealth-maximization as supreme goods”²¹⁵—lawyers should not have given those opinions if the transactions they facilitated violated positive law.²¹⁶

These disconnects between positive law and norms can be relatively easy cases compared to disconnects over time. Sometimes a transaction complies with positive law when the opinion is given (*ex ante*), but positive law thereafter changes to make the transaction unlawful. The question then arises: did counsel have the right to issue that opinion? The obvious response is yes, especially where the transaction complied, *ex ante*, with norms as well as positive law. Some

²¹⁰ William Ewald, *Comparative Jurisprudence: What was it like to Try a Rat?*, 143 U. PA. L. REV. 1889, 2123 (1995) (discussing why lawyers typically rely upon black-letter rules of positive law).

²¹¹ *Cf.* MACEY & MILLER, *BANKING LAW AND REGULATION*, *infra* note 234, at 346 (suggesting that “large [law] firms [are] the most appealing targets because they have the deepest pockets”); Nathan Koppel, *Partial Protection—Plaintiffs Face a Supreme Court Barrier When Suing Law Firms for Fraud*, 26 AM. LAW. 77 (July 2004) (“Law firms are an alluring deep pocket for defrauded investors.”). *See also* Lipson, “Price and Pride,” *supra* note 65, at 5 (“A number of the lawyers interviewed for this project said that they thought that lawyers were becoming increasingly attractive targets when transactions fail, and that opinion letters would form an important link in the chain leading to liability”).

²¹² Ewald, *Comparative Jurisprudence*, *supra* note 210.

²¹³ Gordon, *A New Role for Lawyers?*, *supra* note 82, at 1209.

²¹⁴ *Id.*

²¹⁵ *Id.* Professor Gordon argues, *id.*, that these factors eviscerated the “statesman-advisor” norm of lawyering, discussed *supra* note 82.

²¹⁶ This second disconnect between positive law and norms creates a temptation, of course, to test the boundaries of positive law. Lawyers ought to have the right to do that, so long as those boundaries are not actually violated.

precedents, however, are troubling. There are two scenarios: one where ex-post positive law is not—and the more troublesome scenario where ex-post positive law is—viewed as retroactive.

The first scenario, where ex-post positive law is not viewed as retroactive, is the more common. The Sarbanes-Oxley Act provides an example. As mentioned, the norms governing transactions prior to Enron and WorldCom included an adversary stance of companies toward regulation and regulators and dominance of market economism and shareholder-wealth-maximization.²¹⁷ After those and other corporate failures, however, investor confidence in markets needed to be re-established. That confidence required a showing that “leadership knows what it is doing and that rational [people] are handling the nation’s business rationally.”²¹⁸ Government attempted to accomplish this showing by enacting Sarbanes-Oxley,²¹⁹ subjecting business to more stringently protective laws and standards for behavior.²²⁰ This type of reaction is typical, as illustrated by the enactment of the federal securities laws in response to the Great Depression of 1929-33;²²¹ the aggressive enforcing of existing laws, especially against individuals, in response to the National Student Marketing debacle of the 1970s;²²² and the enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA)²²³ in response to the savings & loan failures of the 1980s.

Although Sarbanes-Oxley clearly codifies changing norms into positive law, it does not appear to make its standards retroactive. A recent court decision confirms that view, at least in the context of retroactively extending certain statutes of limitation. Section 804 of Sarbanes-Oxley creates a new five-year statute of limitations for private securities-fraud cases, and plaintiffs claimed that retroactively extended their lapsed, shorter statutes of limitation. The court disagreed, reasoning that neither the language of that Section nor legislative history suggests that retroactive application was intended.²²⁴

²¹⁷ See *supra* notes 213-215 and accompanying text.

²¹⁸ “ADAM SMITH,” *THE MONEY GAME* 236-37 (1968).

²¹⁹ See *supra* note 18.

²²⁰ Likewise, corporations and other private parties themselves may attempt to increase market confidence by changing the norms by which they behave. See, e.g., Freeman, *Opinion Letters and Professionalism*, *supra* note 29, at 413 (referring to the public apology given by the CEO of General Motors to Ralph Nader): “In an age when the chief executive officer of the world’s largest corporation feels compelled to make a public apology to a private citizen, it is only natural that members of a profession historically vested with a public trust be held to a standard of accountability that accurately reflects the tenor of the times.”

²²¹ JAMES D. COX ET AL., *SECURITIES REGULATION* 3 (2004) (“[T]he Great Depression and the market collapse in October 1929 ... provided the political momentum for congressional action that would over the course of a decade produce a collection of acts known as the federal securities laws.”); *United Housing Found., Inc. v. Forman*, 421 U.S. 837, 849 (1975) (“The primary purpose of the Acts of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securities market.”).

²²² See, e.g., Freeman, *Opinion Letters and Professionalism*, *supra* note 29, at 414 (observing that to “bolster confidence in the securities markets” after that debacle, the SEC took enforcement action against individuals to “impress[] corporate managements and their advisors with the magnitude of their responsibilities under the securities laws and with the potential for personal and professional humiliation as a penalty for failure to discharge those responsibilities”).

²²³ Pub. L. No. 101-73, 103 Stat. 183 (12 U.S.C. § 1821 (2004)).

²²⁴ *In re Enterprise Mortgage Acceptance Co.*, 2004 WL 2785776 (2d Cir. 2004).

The second, and more troublesome, disconnect-over-time occurs where ex-post positive law *is* viewed as retroactive.²²⁵ Unlike retroactive criminal laws, which (at least in the United States and the European Union) are invalid,²²⁶ retroactive non-criminal law is often upheld.²²⁷ This is true even under international legal principles, so long as the retroactive law is non-discriminatory.²²⁸ Retroactivity can be implicit or explicit, although the former has no clear legal basis.²²⁹

The practical problem with retroactive law, of course, is that parties violating it cannot know, at the time of their action, of the violation. Even where parties sense they may be violating norms, that is not *per se* unlawful.²³⁰ In a business and financial context, if not in other contexts, retroactive laws therefore undermine the certainty and objectivity needed to structure transactions.²³¹

Moreover, where the retroactive law concerns a politically sensitive topic, there is potential for abuse.²³² Consider, for example, the much-criticized regulatory action taken, under

²²⁵ Conceptually, this is most likely to occur (but not limited to situations) where there is a retrospective disconnect between positive law and norms, so that ex-post positive law reflects ex-ante norms. *See, e.g.*, Harold J. Krent, *The Puzzling Boundary Between Criminal and Civil Retroactive Lawmaking*, 84 GEO. L.J. 2143, 2158 (1996) (“Retroactivity enhances the ability of a current majority to fashion policies responsive to contemporary interests.”).

²²⁶ Retroactive, or ex post facto, criminal laws violate Article 1, Section 10, of the U.S. Constitution. *See* *Calder v. Bull*, 3 U.S. 386 (1798) (holding that only criminal, not civil, ex post facto laws violate the Constitution). They also generally violate Article 7 of the European Convention on Human Rights. Restrictions on ex post facto criminal law are sometimes referred to as *Nulla poena sine lege* (“no penalty without a law”).

²²⁷ *See, e.g.*, *Landgraf v. USI Film Products*, 511 U.S. 244 (1994); Krent, *The Puzzling Boundary Between Criminal and Civil Retroactive Lawmaking*, *supra* note 225, at 2149 (“the Court has generally sustained any retroactive enactment in the economic sphere that is supported by a plausible public purpose”).

²²⁸ *See* 1 OPPENHEIM’S INTERNATIONAL LAW 918-921 (Sir Robert Jennings & Sir Arthur Watts eds., 9th ed. 1992) (discussing retroactivity in the context of expropriation and confiscation, and concluding that it is permitted so long as it is neither discriminatory nor arbitrary). Where retroactivity amounts to expropriation, however, a State would be liable under international law to compensate the injured parties. *Id.* at 916 n.9. Nonetheless, lawful State actions “may affect foreign interests considerably without amounting to expropriation.” IAN BROWNLIE, *PRINCIPLES OF PUBLIC INTERNATIONAL LAW* 535 (5th ed. 1998).

²²⁹ For an example of dubiously-legal implicit retroactivity, *see infra* notes 233-240 and accompanying text (discussing the OTS case against Kaye, Scholer).

²³⁰ *Cf. supra* note 225.

²³¹ *See, e.g.*, George Clemon Freeman, Jr., *A Public Policy Essay: Superfund Retroactivity Revisited*, 50 BUS. LAW. 663, 682 (1995) (“The key to continuing investments in productive enterprises, and to the availability of insurance to facilitate those investments, is predictability. Predictability in turn is dependent upon a stable legal system where those who must make decisions on whether or not to act or how to act, and those who must decide whether or not to insure them and if so at what price, can do so with fairly accurate knowledge of the likely legal consequences. ... Retroactive legislation ... is antithetical to predictability.”).

²³² This potential for abuse to some extent reflects the previously-discussed flawed syllogism: the public is harmed; legal opinions are a *sine qua non* of the harm, and the opining lawyers are the only deep pockets; therefore, those lawyers should be liable for the harm. *See supra* note 211 and accompanying text. Objectively, however, lawyers should not be liable if the transactions they opined on did not violate

FIRREA, by the United States Office of Thrift Supervision (OTS) against the law firm of Kaye, Scholer, Fierman, Hays & Handler (Kaye, Scholer).²³³ Kaye, Scholer had been retained as litigation counsel for Lincoln Savings & Loan Association (Lincoln) in an adversarial relationship with the OTS.²³⁴ Lincoln subsequently failed, being \$2.6 billion insolvent.²³⁵ Almost two years later, the OTS filed its regulatory action against Kaye, Scholer, alleging essentially that the law firm failed to disclose to the OTS's predecessor Lincoln's actual financial condition.²³⁶ Kaye, Scholer countered that it had no such disclosure duty, and indeed that the OTS's charge was a "completely groundless ... attempt ... to create and apply new standards for attorney conduct that are different from, and inconsistent with, generally accepted professional standards and ethical obligations for lawyers representing a client."²³⁷ The OTS, in response, claimed that FIRREA retroactively imposes on a bank's counsel a duty to regulators as well as to the client,²³⁸ and that Kaye, Scholer should have complied with that duty when representing Lincoln—even though it was not then law.²³⁹

This controversy was settled, and never adjudicated on the merits.²⁴⁰ Commentators, however, see it as emblematic of politicized abuse of retroactive law, at even the highest levels of government.²⁴¹

positive law when their opinions were given. *See supra* note 209 and following text. *But cf.* Freeman, *Opinion Letters and Professionalism*, *supra* note 29, at 375 (observing, in 1973, that "times have changed" and thus "[r]esponsibilities that were never recognized previously have now come into view") and at 376 (contending that "as attorneys come to be idealized as the 'due diligence men' and the 'corporate conscience,' they must expect that the changing times will require of them a stricter accountability for their actions") (citations omitted).

²³³ The author discloses that he was a partner of Kaye, Scholer at the time of this regulatory action, though not at the time Kaye, Scholer engaged in any actions alleged to be problematic. The author therefore was not involved in the regulatory action.

²³⁴ JONATHAN R. MACEY & GEOFFREY P. MILLER, *BANKING LAW AND REGULATION* 341 (2d ed. 1997).

²³⁵ HOWELL E. JACKSON & EDWARD L. SYMONS, JR., *REGULATION OF FINANCIAL INSTITUTIONS* 419 (1999) (quoting James O. Johnston & Daniel S. Schechter, *Kaye, Scholer and the OTS—Did Anyone Go Too Far?*, 66 S. CAL. L. REV. 977, 979-83 (1993)).

²³⁶ JACKSON & SYMONS, *REGULATION OF FINANCIAL INSTITUTIONS*, *supra* note 235, at 419-20.

²³⁷ *Id.* at 420.

²³⁸ Under FIRREA, attorneys advising federally-insured depository institutions are regarded as "institution-affiliated parties." 12 U.S.C. § 1813(u). The OTS, under its then-Chief Counsel Harris Weinstein, relied in part on that provision to conclude that such attorneys owe, *and retrospectively have owed*, a fiduciary obligation to those institutions. Joseph E. Addiego III, Comment, *FIRREA Disrupts Traditional Notions of Attorney Duty by Exposing Lawyers, as Financial Institution-Affiliated Parties, to Personal Liability*, 33 SANTA CLARA L. REV. 969, 971 (1993). *See also id.* at 973 (observing that "[t]he passage of FIRREA changed, or at least modified, the existing law regarding attorneys' fiduciary duties") & 978 ("By including attorneys as institution-affiliated parties, FIRREA exposes attorneys to personal liability when a depository fails").

²³⁹ The author states this from personal experience as a Kaye, Scholer partner at that time.

²⁴⁰ Kaye, Scholer did not have the opportunity to contest the OTS's action because, in connection with the action, the OTS froze the law firm's assets without opportunity for a prior hearing. The OTS imposed the freeze by issuing a temporary cease-and-desist order under 12 U.S.C. § 1818 (b) & (c). *See, e.g.*, JACKSON & SYMONS, *REGULATION OF FINANCIAL INSTITUTIONS*, *supra* note 235, at 421. Some question the OTS's authority to even issue this order. *See* LISSA L. BROOME AND JERRY W. MARKHAM, *REGULATION OF BANK FINANCIAL SERVICE ACTIVITIES* 564 (2001). Kaye, Scholer had no realistic choice but to immediately settle: any administrative hearing probably would have taken months (JACKSON & SYMONS, *REGULATION*

For these reasons—the potential for abuse, and the lack of certainty and objectivity needed to structure business and financial transactions—retroactivity should be frowned on. Even more so in the context of legal opinions, retroactivity should not be used as a basis to impose liability on opining lawyers.²⁴² Opining lawyers, unlike companies relying on their advice, are professionals. As such, they are not (at least under today’s norms) the ultimate guarantors of legality but, instead, experts in a learned body of knowledge.²⁴³ If that knowledge later changes—and especially if it changes unpredictably—the lawyer still would have complied with all professional obligations when rendering the opinion. That is all a lawyer can do.²⁴⁴ Legal

OF FINANCIAL INSTITUTIONS, *supra* note 235, at 421), and the law firm’s banks—as a result of the OTS’s regulatory action—had declared a material adverse change, suspending the firm’s lines of credit needed to pay salaries and other current expenses. The author states this from personal experience as a Kaye, Scholer partner at that time.

²⁴¹ See, e.g., MACEY & MILLER, *BANKING LAW AND REGULATION*, *supra* note 234, at 345 (“Wasn’t it particularly unfair for the OTS to take after Kaye, Scholer without giving formal advance warning that it intended to hold law firms representing thrift institutions to a different standard than the traditional standard of adversary representation in which law firms have traditionally engaged? ... [By] “targeting lawyers, the OTS managed to do battle with a group even less popular than itself and to create the impression that it [the OTS] was not to blame for the continuing crisis in the banking industry.”); JACKSON & SYMONS, *REGULATION OF FINANCIAL INSTITUTIONS*, *supra* note 235, at 420 (quoting the opinion of Professor Geoffrey Hazard, a leading legal-ethics expert, that “Kaye, Scholer did not violate existing standards of ethical conduct and professional responsibility, and Kaye, Scholer acted in accord with its duties under the law. The disclosures and representations that the OTS alleges should have been made by Kaye, Scholer in fact would have violated the standards of ethical conduct and professional responsibility generally recognized in its role as litigation counsel.”); Jonathan R. Macey & Geoffrey P. Miller, *Kaye, Scholer, FIRREA, and the Desirability of Early Closure: A View of the Kaye, Scholer Case From the Perspective of Bank Regulatory Policy*, 66 S. CAL. L. REV. 1115 (1993) (concluding that the OTS took its regulatory action because it “needed a convenient, unpopular scapegoat that it could confront with a dramatic gesture designed to help it regain its prestige”).

²⁴² Recall that this article uses the term “liability” to include any form of governmental constraints, including civil liability, criminal liability, and suspension or termination of the license to practice law. See *supra* note 134.

²⁴³ See *Legal Opinion Principles*, *supra* 67, § I.A at 832 (maintaining that legal opinions are “expressions of professional judgment regarding the legal matters addressed and not guarantees that a court will reach any particular result”); *Guidelines for the Preparation of Closing Opinions*, *supra* note 55, § 1.1 at 875 (stating that opinions serve to “provid[e] 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”). Cf. TriBar Committee, *Legal Opinions to Third Parties: An Easier Path*, *supra* note 47, at 1896 (stating that “it should be understood that an opinion is not a guaranty, but merely a lawyer’s informed judgment as to a specific question of law”).

²⁴⁴ As a practical matter, legal opinions sometimes explicitly state that they are limited to the law in effect on the date the opinion is given. Cf. M. JOHN STERBA, JR., *LEGAL OPINIONS LETTERS: A COMPREHENSIVE GUIDE TO OPINION LETTER PRACTICE* § 2:13 *Undertakings as to Subsequent Events* (3d ed. 2003) (“[S]ome lawyers will state in their opinions that they ‘assume no responsibility to communicate with you with reference to changes which may occur subsequent to the date hereof’”). Although primarily intended to put the opinion-recipient on notice that counsel has no duty to update the opinion if the law changes, this statement in an opinion also would have the incidental benefit of clarifying, essentially as a matter of contract, that counsel is not responsible for a later retroactive change in law. *Id.* See also TriBar Opinion Committee, *Third-Party “Closing” Opinions*, *supra* note 55, § 6.6 (With respect to no violation of law opinions, “the opinion covers only those laws (including published rules and regulations) in effect on the date of the opinion letter and laws and published rules and regulations adopted on that date that by their terms are to take effect while the Company is performing its obligations under the agreement.”).

opinions, and the lawyers giving them, therefore should not be criticized solely because a change in positive law makes the transaction opined on retroactively unlawful.

Statement of the framework: Having resolved these ancillary issues, it is now possible to articulate the normative completed framework. Lawyers should have the right to issue opinions that help facilitate lawful structured-finance transactions. By “lawful,” I mean that neither the lawyer’s opinion-giving nor, to the extent set forth below, the transaction being opined on is either illegal or unethical as a matter of positive law—nor, ideally, do they violate norms—at the time the opinion is issued.²⁴⁵ In assessing whether a transaction is lawful, the lawyer should examine at least the portion thereof relating to the opinion. If, however, in the course of that examination the lawyer spots warning signs, the lawyer should investigate further before issuing the opinion. What constitutes a warning sign should be decided by courts on a case-by-case basis because warning signs are more easily recognized than defined. In appropriate cases, the lawyer may want to obtain, as part of the due diligence investigation, an opinion from in-house counsel stating that the overall transaction does not violate law. Failure of in-house counsel to render such an opinion would signal a problem.

Is this framework, which imposes relatively minimal constraints on structured-finance opinions and the lawyers issuing them, preferable to potentially more restrictive frameworks? In the post-Enron regulatory environment, for example, scholars have vigorously criticized lawyer conduct, suggesting the need for greater constraints. My analysis, however, implicitly has demonstrated that this framework is superior to, or at least equally efficient as, other potential frameworks. The rationale is as follows. Structured-finance opinions are an efficient means of facilitating lawful structured-finance transactions.²⁴⁶ Lawful structured-finance transactions are themselves, on balance, efficient, fair, and economically desirable.²⁴⁷ The only deficiency in these transactions—occasional information failure—occurs independent of lawyer conduct and has solutions that are likewise independent.²⁴⁸ Therefore, any framework for issuing structured-finance opinions that imposes greater constraints on lawyer conduct than this article’s framework would impose costs that yield no real benefit.

Moreover, as vigorously as scholars have criticized lawyer conduct,²⁴⁹ upon close scrutiny the scholarship often does not propose actual legal constraints on, but merely aspirational goals for, such conduct.²⁵⁰ And, where the scholarship proposes legal constraints, they are often

²⁴⁵ Where the transaction being opined on is lawful as a matter of positive law but nonetheless may violate norms, the lawyer may want to exercise special caution in issuing the opinion.

²⁴⁶ See *supra* note 131 and accompanying text (discussing that these opinions facilitate structured-finance transactions in an efficient way, by targeting the precise two elements of information asymmetry of concern to investors). See also *supra* notes 101-104 and accompanying text and notes 189-208 and accompanying text (discussing why the scope of due diligence proposed by this article’s framework is optimal).

²⁴⁷ See *supra* note 32 and accompanying text.

²⁴⁸ See *supra* notes 160-182 and accompanying text.

²⁴⁹ See, e.g., Koniak, *When the Hurlyburly’s Done*, *supra* note 3; Griffith, *Towards an Ethical Duty to Market Investors*, *supra* note 157. See also Richard W. Painter, *The Moral Interdependence of Corporate Lawyers and Their Clients*, 67 SO. CAL. L. REV. 507 (1994).

²⁵⁰ See, e.g., Painter, *The Moral Interdependence of Corporate Lawyers and Their Clients*, *supra* note 249 (arguing that, at least as a moral matter, lawyers sometimes should second guess their corporate clients).

impractical²⁵¹ and not demonstrably preferable to this article’s framework which, by following the social-ordering paradigm, should achieve an optimal public outcome overall.²⁵²

I next illustrate the framework’s application by examining several different hypothetical scenarios. In that context, I also examine how the framework would apply where the assumption that the legal opinion is correct is relaxed.

Applying the framework: Consider first how this article’s framework would apply to a technically-correct structured-finance opinion delivered in a *pre*-Sarbanes-Oxley transaction, which subsequently collapses, leaving shareholders of the originator with huge losses as a result of contingent recourse that wipes out most of their equity. Because lawyers should have the right to issue opinions that help facilitate structured-finance transactions that are neither illegal nor unethical as a matter of positive law at the time the opinion is issued, this opinion should not be subject to criticism, and the lawyer issuing it should not be subject to liability. Notwithstanding the shareholders’ losses, lawyers are not, and should not be, ultimate guarantors of a transaction’s success.²⁵³

The foregoing assumes that the lawyer examined at least the portion of the transaction relating to the opinion. If, however, in the course of that examination the lawyer spotted appropriate warning signs, such as in-house counsel’s failure to render a requested no-violation-of-law opinion, and did not investigate further, the lawyer should be subject to criticism if not liability—notwithstanding the structured-finance opinion being technically correct.

The same analysis would apply to a technically-correct structured-finance opinion delivered in a *post*-Sarbanes-Oxley transaction, which subsequently collapses leaving shareholders of the originator with huge losses as a result of contingent recourse that wipes out most of their equity. Even though, as discussed below,²⁵⁴ Sarbanes-Oxley might impose securities-law liability for mere negligence, the hypothetical assumes that the structured-finance opinion is technically correct; thus, there is no negligence. The opining lawyer therefore will not, and—because lawyers are not ultimate guarantors of a transaction’s success—should not, be liable. Shareholders nonetheless may be able to recover losses from the originator’s officers and directors to the extent the contingent recourse was fraudulently concealed.²⁵⁵

Now relax the framework’s assumption that the legal opinion is technically correct. For this purpose, again break the analysis into two parts: an *incorrect* structured-finance opinion

²⁵¹ Cf. Griffith, *Towards an Ethical Duty to Market Investors*, *supra* note 157, at 1232 (arguing that a lawyer should be responsible for seeking outcomes that “are optimal from the perspective of the public generally, not merely from a particular client’s point of view”) *with id.* at 1233 (admitting that his proposal “seems a bit abstract”). Although Professor Griffith subsequently argues that his proposal could be applied to an actual case by having investors stand in for the “public,” the example he uses appears internally inconsistent as to whether those investors are investors in the originator or the SPV. *See id.* at 1237-39.

²⁵² Under that paradigm parties left to independent bargaining work out arrangements that, except to the extent the arrangements create unlawful externalities, overall benefit the social good. *See supra* note 154 and accompanying text.

²⁵³ *See supra* note 243 and accompanying text. Cf. TriBar Opinion Committee, *Third-Party “Closing” Opinions*, *supra* note 55, § 1.2 (“An opinion is not a guaranty of an outcome, but rather an expression of professional judgment”).

²⁵⁴ *See infra* notes 262-272 and accompanying text.

²⁵⁵ *See infra* notes 262-263 and accompanying text (discuss § 303 of Sarbanes-Oxley).

delivered in a pre-Sarbanes-Oxley transaction, and one delivered in a post-Sarbanes-Oxley transaction. In both cases, I will assume that opining counsel intended to give a correct opinion, but was negligent.²⁵⁶

In the former case,²⁵⁷ the framework itself need not change, even though it was constructed under the assumption that the opinion is correct. The framework only need recognize existing liability standards for rendering incorrect opinions. Negligence law, and lawyer liability thereunder, provide a significant incentive to motivate opining counsel to strive for a correct opinion.²⁵⁸ Reputational cost provides an important additional incentive.²⁵⁹ In cases where these incentives fail, damages assessed against opining counsel ought to compensate the originator's shareholders for any losses resulting from the incorrect opinion.²⁶⁰

In the latter case (i.e., an incorrect structured-finance opinion delivered in a post-Sarbanes-Oxley transaction), this same rationale should apply even more strongly because opining counsel not only would be liable under negligence law and subject to reputational costs but also might be liable under Sarbanes-Oxley, which exposes counsel to securities-law penalties.²⁶¹ Section 303 of that Act²⁶² directs the SEC to adopt rules making it illegal for officers and directors of issuers of securities, or any persons acting under their direction, to “fraudulently influence, coerce, manipulate, or mislead” any independent public or certified accountant auditing the issuer’s financial statements “for the purpose of rendering such financial statements materially misleading.”²⁶³ The SEC consequently issued Rule 13b2-2,²⁶⁴ which provides in relevant part that “[n]o ... person acting under the direction [of an issuer’s officers or directors] shall directly or indirectly take any action to ... mislead” any such accountant “if that person knew or should have known that such action, if successful, could result in rendering the issuer’s financial statements

²⁵⁶ Where opining counsel intends to give an incorrect opinion, the inherent fraud is obviously problematic (and beyond the scope of this article).

²⁵⁷ This case assumes, as discussed *supra* note 224 and accompanying text, that Sarbanes-Oxley is not retroactive.

²⁵⁸ One commentator argues that “the real value added by the threat of legal liability may be (or at least has been) in *terrorem*, and not directly traceable to actual cases holding lawyers liable. ‘[T]he fact that there aren’t a lot of cases to hold lawyers liable,’ one attorney [being interviewed by the commentator] observed, ‘and there isn’t a lot of experience of lawyers being sued, doesn’t mean that people aren’t fearful of it nevertheless. It’s like fastening your seatbelt on an airplane. I don’t know anyone who’s been through a plane crash much less someone who has been through a crash who would not have survived if they weren’t wearing their seatbelt. Nevertheless, I buckle my belt low and firm across the lap.’” Lipson, “Price and Pride,” *supra* note 65, at 76-77.

²⁵⁹ See, e.g., Richard W. Painter, *Convergence and Competition in Rules Governing Lawyers and Auditors*, 29 J. CORP. L. 397, 411-12 (2004) (observing that lawyers and other professional gatekeepers “involved in corporate scandals ... face loss of reputation, the very asset that allows [them] to sell their services to issuers in the first place. These ‘market reputation’ and ‘litigation’ corrections ... may be as effective as, if not more effective than, regulation”). Accord, Lipson, “Price and Pride,” *supra* note 65, at 76-77.

²⁶⁰ See *supra* note 182 and accompanying text.

²⁶¹ Penalties under Rule 13b2-2, which implements Sarbanes-Oxley § 303, include cease-and-desist orders, injunctions, and civil or criminal penalties. See, e.g., *In re John K. Bradley*, Release No. 46035 (2002), 2002 SEC LEXIS 1448 (imposing a § 21C cease-and-desist order).

²⁶² Section 303 is codified at 15 U.S.C. § 7242.

²⁶³ 15 U.S.C. § 7242(a).

²⁶⁴ 17 C.F.R. § 240.13b2-2.

materially misleading.”²⁶⁵ The SEC Release accompanying issuance of that rule makes it clear that persons acting under such direction could, in appropriate circumstances, include attorneys,²⁶⁶ and even could include attorneys who merely negligently issue “an inaccurate or misleading legal analysis” on which any such accountant is permitted to rely.²⁶⁷ This means that an attorney negligently issuing an inaccurate true-sale or non-consolidation opinion might be violating Rule 13b2-2 if an accountant is allowed to rely on that opinion to find, under GAAP, that the transaction in question is off-balance sheet.

In a sense, § 303 of Sarbanes-Oxley illustrates this article’s contention that where lawyers facilitate lawful transactions that create problematic externalities, the focus should be on legally prohibiting those transactions.²⁶⁸ Section 303 effectively declares unlawful, as a matter of positive law, misleading off-balance sheet transactions. Rule 13b2-2 might be viewed as undercutting that contention, though, to the extent it imposes securities-law penalties on lawyers that merely negligently facilitate misleading off-balance sheet transactions. I believe, however, that Rule 13b2-2 may go too far. Although the Rule’s higher securities-law penalty arguably will motivate lawyers to increase their due diligence when issuing structured-finance opinions, these opinions are rarely incorrect²⁶⁹ because negligence law and reputational cost already significantly motivate opining counsel to strive for correct opinions.²⁷⁰ Moreover, third parties injured by incorrect opinions already should be compensated.²⁷¹ Therefore it is unclear whether the cost of increased due diligence is justified.²⁷²

²⁶⁵ Rule 13b2-2(b)(1).

²⁶⁶ SEC Release No. 47890, 2003 WL 21148349, at 3.

²⁶⁷ *Id.* at 4, 6. The SEC Release is somewhat ambivalent as to whether, in addition to mere negligence, any degree of scienter will be required to violate Rule 13b2-2. *See* SEC Release No. 47890, *supra* note 266, at 4 (citations omitted; emphasis added): “[S]ome commentators noted that a misleading legal analysis should violate the rule only if accompanied by fraudulent or ‘bad’ intent on the part of the attorney providing the analysis. These comments would appear to be based on the premise that in the past the Commission has not addressed the negligent communication of misleading information to auditors.... To the contrary, for many years we have initiated enforcement actions against those who, by negligently providing misleading confirmations to auditors, cause an issuer to violate the financial reporting or books and records provisions of the Securities Exchange Act of 1934. ... We believe that third parties providing information or analyses to an auditor should exercise reasonable attention and care in those communications [although] [w]e do not intend to hold any party accountable for honest *and reasonable* mistakes....”

²⁶⁸ *See supra* notes 158-59 and accompanying text.

²⁶⁹ *See supra* note 28 and accompanying text.

²⁷⁰ *See supra* notes 257-259 and accompanying text.

²⁷¹ *See supra* note 260 and accompanying text.

²⁷² Even to the extent one argues that increased due diligence is needed, irrespective of cost, because incorrect structured-finance opinions potentially impact large numbers of investors and public-market integrity (*cf.* Freeman, *Opinion Letters and Professionalism*, *supra* note 29, at 418 (arguing that “the lawyer’s ‘responsibility must broaden and deepen’ as more individuals find it increasingly necessary to rely upon his expertise”); *Neel v. Magana, Olney, Levy, Cathcart & Gelfand*, 491 P.2d 421, 432-33 (Cal. Sup. Ct. 1971) (same)), willfulness, scienter, or recklessness is normally required to impose securities-law penalties. *See, e.g., Ernst & Ernst v. Hochfelder*, 425 US 185, 193 (1976) (holding that “a private cause of action for damages will [not] lie under § 10(b) and Rule 10b-5 in the absence of any allegation of ‘scienter’—the intent to deceive, manipulate, or defraud”).

These applications show how this article’s framework can be used to assess lawyer responsibility for structured-finance opinions. As a reality check, compare how the framework would apply to a hypothetical scenario analyzed, in a separate context, by Professor Gordon. He contends that lawyers should not facilitate client transactions that, though “technically legal,” are “likely to bring destruction in [their] wake.”²⁷³ This certainly appears sensible: where a lawyer believes a transaction is *likely to bring destruction*, the lawyer probably should not facilitate that transaction. As a practical matter, however, Professor Gordon’s view is not inconsistent with this article’s framework. If the destruction is to the client itself,²⁷⁴ only an immense judgment gap between management and counsel could produce a scenario where the former believe a transaction is desirable but the latter believes it is likely to bring destruction. And, if the destruction is to third parties, Professor Gordon’s hypothetical could arise only in a legal system in which the transaction causing the destruction is neither unlawful²⁷⁵ nor subjects the client to liability.²⁷⁶ The framework therefore satisfies this reality check.

The framework also has predictive utility. Consider, for example, whether the holding in *U.S. v. Simon* should be extended to lawyers providing legal opinions.²⁷⁷ The lawyer is not then advocating for a client but, rather, predicting as accurately as possible the legal outcome of a given factual scenario. The American Law Institute’s Restatement of Law Governing Lawyers even comments that a lawyer’s duty to third-party-opinion recipients “is to provide a fair and objective opinion”²⁷⁸—essentially the same standard that an accountant has in certifying financial statements.²⁷⁹ In principle, therefore, the *U.S. v. Simon* holding should be as applicable to opining lawyers as to accountants.²⁸⁰ Nonetheless, this article’s framework suggests a distinction in how that holding should apply. In contrast to an accountant whose responsibility is to fairly present financial statements, the opining lawyer’s sole duty is to present an accurate, fair, and objective opinion *on the legal matters the opinion purports to cover*. A lawyer rendering an accurate opinion that fairly and objectively presents *those* legal matters should not—absent knowledge, or

²⁷³ Gordon, *A New Role for Lawyers?*, *supra* note 82, at 1207.

²⁷⁴ This is the scenario that Gordon envisions. *See id.*

²⁷⁵ If the transaction is unlawful, the lawyer could not provide the requested opinion in the first place. *See supra* notes 155-158 and accompanying text.

²⁷⁶ If the transaction subjects the client to liability, third parties could sue, thereby transferring the costs of the destruction from them to the client. Then we would be under the remote prior scenario, where the client’s management believe a transaction is desirable but counsel believes it’s likely to bring destruction. *See supra* note 274 and accompanying text.

²⁷⁷ *Cf. supra* notes 145-147 and accompanying text (discussing *U.S. v. Simon*).

²⁷⁸ RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 95, comment c (2000).

²⁷⁹ *See supra* notes 146-147 and accompanying text. *Cf. Gordon, A New Role for Lawyers?*, *supra* note 82, at 1194 (questioning whether corporate lawyers are truly like advocates whose duties are only to the client, as opposed to like auditors whose duties are to the public); Painter, *Convergence and Competition in Rules Governing Lawyers and Auditors*, *supra* note 259, at 398 (arguing that “[e]thics rules are becoming increasingly similar for auditors and securities lawyers,” although there are “differences”).

²⁸⁰ *Cf. Freeman, Opinion Letters and Professionalism*, *supra* note 29, at 389 (arguing that “it is in the rendition of formal opinions that the services performed by the two professions [law and accounting] shade together and become indistinguishable”—such as the role provided by a bond-counsel legal opinion; though also cautioning that one cannot compare a legal opinion to an auditor’s certification “without regard to the setting in which the legal opinion is rendered”). *Cf. U.S. v. Benjamin*, 328 F.2d 854, 863 (2d Cir. 1964) (noting that in “our complex society the accountant’s certificate and the lawyer’s opinion can be instruments for inflicting pecuniary loss more potent than the chisel or the crowbar”).

the existence of warning signs that would lead to knowledge, of the wrongful nature of the accountant's conduct²⁸¹—be subject to liability under *U.S. v. Simon*.²⁸²

To illustrate this, consider the difficult case where a lawyer renders an accurate structured-finance opinion that fairly and objectively presents the bankruptcy-law matters that the opinion purports to cover (true sale and non-consolidation), *knowing* that the sole purpose of the transaction is to achieve off-balance sheet accounting results under GAAP (and thereby avoid the adverse effect on stock price of the disclosure that otherwise would take place). If this constitutes knowledge of wrongful conduct, the lawyer should be subject to liability. There is nothing per se wrongful, however, about a company engaging in a transaction to achieve accounting results that are permitted under GAAP—which sets accounting standards officially recognized as authoritative by the SEC.²⁸³ Moreover, the fact that a company engages in such a transaction should not, in and of itself, constitute a warning sign if the company is advised by certified public accountants. A lawyer ought to be able to assume that such accountants will comply with GAAP,²⁸⁴ unless on notice otherwise.²⁸⁵ To the extent society deems it inappropriate for companies to engage in transactions whose sole purpose is to achieve off-balance sheet accounting results under GAAP, the solution—assuming reputational cost is an insufficient deterrent²⁸⁶—is either to make those engagements unlawful, or to restrict what is permitted as off-balance sheet accounting under GAAP²⁸⁷—not to constrain lawyers from helping to facilitate lawful transactions.²⁸⁸

²⁸¹ This article's "knowledge" standard may well require more of the attorney than existing positive-law ethical requirements. *Cf.* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 94, comment g (2000) (stating that "[w]hen a lawyer's state of knowledge is relevant, in the absence of circumstances indicating otherwise, a lawyer may assume that a client will use the lawyer's counsel for proper purposes. Mere suspicion on the part of the lawyer that the client might intend to commit a crime or fraud is not knowledge. . . . [A] lawyer is not required to make a particular kind of investigation in order to ascertain more certainly what the facts are, although it will often be prudent for the lawyer to do so.").

²⁸² *See supra* notes 118-120 and accompanying text.

²⁸³ *See supra* notes 41, 108, & 109 and accompanying text. Indeed, companies routinely engage in transactions primarily if not solely to achieve accounting results that are permitted under GAAP, such as selling assets and using the proceeds to repay debt, thereby reducing leverage. [cite]

²⁸⁴ *Cf.* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 94(2)(b) (2000) (stating that a lawyer should not be disciplined "when the lawyer reasonably believes . . . that the client can assert a nonfrivolous argument that the client's conduct will not constitute a crime or fraud"). The client's argument in the text above would indeed be non-frivolous: that its accounting will remain in compliance with GAAP. *Also cf. supra* note 32 (citing *Enron and the Use and Abuse of Special Purpose Entities in Corporate Structures*, *supra* note 12, at 1315-17, for the proposition that even transactions designed solely to achieve accounting results should not be presumptively unlawful).

²⁸⁵ That notice is unlikely to arise as a result of the lawyer's independent understanding of GAAP because knowledge about, much less expertise in, GAAP is well beyond the learning of most attorneys. *See supra* note 111 and accompanying text. The textual analysis above of course assumes, where a transaction is facilitating fraud, that opining counsel neither knows nor reasonably should know of the fraud. *See supra* notes 29 & 189-204 and accompanying text.

²⁸⁶ To some extent, the problem will be self-correcting where reputational costs penalize companies that engage in these transactions. *See, e.g., Rethinking the Disclosure Paradigm in a World of Complexity*, *supra* note 20, at 20 & 20 n. 120 (observing this reputational cost, in the form of falling stock prices, of companies engaging in earnings management transactions).

²⁸⁷ Indeed, on June 15, 2005, the SEC staff released its report on off-balance sheet transactions, *Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 On Arrangements with*

This approach is sensible. It respects the social-ordering paradigm while recognizing that controlling management action is, and should be, primarily an internal governance issue, not a general monitoring function of outside lawyers. Corporate governance principles require management to maximize shareholder value. To the extent transactions structured to achieve accounting results ultimately hurt the company's shareholders, one of four things may be happening. The transaction may have appeared, *ex ante*, to be positive-value but turned out, *ex post*, to be negative-value—a bad judgment call for which no law that respects managerial discretion can provide complete protection (and as to which corporate-governance systems in the United States if not abroad generally follow the business-judgment rule to provide managerial discretion²⁸⁹). Or management may be biased due to manufactured conflicts of interest, as in Enron—a scenario separately addressed by the solution that management be required to be free of material conflicts of interest stemming from complex transactions for which disclosure may be insufficient.²⁹⁰ Or management may be biased due to the inherent conflict of interest that stock price is the principal criterion by which management's performance is judged. This bias, however, does not mean that accounting-motivated transactions should be necessarily unlawful. Even though corporate governance principles require management to maximize shareholder value, there is a temporal conflict between current and future shareholders: disclosure of a possible risk harms a company's current shareholders, whereas failure to disclose the risk may harm the company's future shareholders.²⁹¹ On which audience should disclosure be focused? Corporation law provides that management's sole duty is to *current* shareholders²⁹²; and they, unlike future shareholders, would likely benefit from accounting-motivated transactions.²⁹³

Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers, focusing among other things on whether financial statements of issuers of securities transparently reflect the economics of off-balance sheet arrangements. The Report recommends that “transactions and transaction structures primarily motivated by accounting and reporting concerns, rather than economics” be discouraged through a combination of changes to accounting standards by FASB and greater awareness by participants in the financial reporting process. *Id.* at 3. In this latter context, the Report suggests, consistent with the *U.S. v. Simon* case (though not citing it), that technical compliance with financial reporting requirements would be unsatisfactory where investors are nonetheless misled or have insufficient information to understand the issuer's activities. *Id.* The Report questions nuanced approaches to accounting disclosure because “financial structures are virtually limitless and continue to evolve at a rapid pace.” *Id.* at 46. Instead, it suggests that “improvement in transparency and comparability across issuers can perhaps most directly and quickly be accomplished by eliminating the use of” structured transactions whose sole (or perhaps even primary) purpose is motivated by accounting treatment.” *Id.* at 45.

²⁸⁸ See *supra* note 182 and accompanying text.

²⁸⁹ See *In re Abbotts Labs. Derivatives S'holders Litig.*, 325 F.3d 795, 805 (7th Cir. 2003) (stating that “where there is no conflict of interest or no facts suggesting suspect motivation, it is difficult to charge directors with responsibility for corporate losses for an alleged breach of care”).

²⁹⁰ See *supra* notes 177-180 and accompanying text.

²⁹¹ See generally Steven L. Schwarcz, *Temporal Perspectives: Resolving the Conflict Between Current and Future Investors*, 89 MINN. L. REV. __, __ (forthcoming April 2005) (discussing this temporal conflict). Future shareholders could be harmed if, after they purchase their shares, the undisclosed risk occurs, causing share price to fall.

²⁹² *Temporal Perspectives*, *supra* note 291 (demonstrating that “[d]irectors and management, at least in the United States, have a fiduciary duty *only* to investors holding an existing property right or equitable interest to support such a duty—i.e., current investors”) (citing *Simons v. Cogan*, 549 A.2d 300, 304 (Del. 1988)).

²⁹³ This responds, solely for illustrative purposes, to a normative question (on which audience should disclosure be focused?) with a positive-law answer. In this context, I recognize that federal securities law,

Where, however, management is simply defrauding shareholders, there are far more systematic monitors than opining counsel (though any opining counsel that becomes aware of the fraud would, of course, have to report it²⁹⁴). In-house counsel are in a better position to monitor because they generally have more information about the company and its business goals²⁹⁵ and also because, as employees, they are not normally engaged to work only on discrete transactions.²⁹⁶ Many in-house legal staffs have attorneys specifically dedicated to corporate compliance with law.²⁹⁷ The company's accountants, of course, serve also as additional monitors.²⁹⁸

This is not to say that opining counsel should not act as monitors. To the extent discussed,²⁹⁹ they should serve as monitors of *transactional lawfulness*, an intrinsically unlawful transaction being the ultimate warning sign.³⁰⁰ Transactional lawfulness, however, should not be conflated with *corporate lawfulness*: whether the transaction would be lawful if (or as) engaged in by the particular client-company. A transaction can be lawful on its face—there is nothing intrinsically unlawful, for example, about accounting transactions that comply with GAAP—but

which would preempt inconsistent state corporation law, sometimes may impose duties to future as well as current shareholders. *See Temporal Perspectives, supra* note 291. So long as management is able to certify fair presentation under § 302 of Sarbanes-Oxley, however, I am unaware of any securities-law precedent that would make it unlawful for management to engage in a GAAP-permitted transaction. I also would be skeptical of any such precedent so long as GAAP rules are promulgated pursuant to SEC delegation of power. *See supra* note 41 and accompanying text.

²⁹⁴ *See supra* notes 104 & 189-204 and accompanying text.

²⁹⁵ Once upon a time, outside counsel were, for the most part, both corporate and transactional counsel. Lawyers working on corporate matters then would work hand in hand with, or sometimes be the same as, the lawyers working on transactions. As legal fees have risen, companies have brought the more routine corporate counsel work in-house and engage outside firms primarily, if not exclusively, for sophisticated transactional work. *See, e.g., The Inside Track to Cost Containment*, AM. LAW. 40 (Dec. 1990) (observing that “toward the end of the 1980s general counsel . . . add[ed] lawyers to in-house staffs and [limited] the amount and types of legal matters being referred outside”).

²⁹⁶ Indeed, at the March 21, 2005 Columbia Law School Symposium on this article, Sullivan & Cromwell-Partner Rebecca Simmons observed that a strong internal legal department can help to see the overall picture and ensure all the advice is coherent.

²⁹⁷ *See In-House Counsel Must Lead Corporate Compliance Efforts*, 11 CORP. LEGAL TIMES, Issue 114, at 18 (May 2001) (stating that “[c]orporate compliance is one of the key roles” that in-house counsel performs). This trend follows the recognition that board-of-director duties “embrace[] some responsibility to determine ‘that the corporation’s information and reporting systems are in concept and design adequate to assure the board that appropriate information will come to its attention in a timely manner.’” William H. Simon, *Wrongs of Ignorance and Ambiguity: Lawyer Responsibility for Collective Misconduct*, 22 YALE J. REG. 1, 25 (2005) (quoting with approval *In re Caremark Int’l, Inc., Derivative Litig.*, 698 A.2d 959, 969 (Del. Ch. 1996)).

²⁹⁸ This monitoring is increased where certified public accountants approve the accounting result sought by the company as complying with GAAP. *Cf. supra* note 284 and accompanying text.

²⁹⁹ *See supra* notes 188-204 and accompanying text.

³⁰⁰ Recall that opining counsel should assess the transaction’s lawfulness by examining at least the portion thereof relating to the opinion. *See supra* note 245 and accompanying text (“Statement of the framework”). If in the course of that examination the lawyer spots warning signs, the lawyer should investigate further before issuing the opinion. *See also supra* notes 104 & 189-204 and accompanying text (discussing warning signs).

unlawful if engaged in by that company. If the transaction is not intrinsically unlawful, only counsel with full information of the company—that is, in-house counsel—are in a position to effectively judge corporate lawfulness.

This article has focused primarily on the duties of lawyers issuing opinions in, *as opposed to structuring*, transactions. In principle, the article’s overall framework should hold even if opining counsel also helps structure the transaction. As structuring counsel, the lawyer is acting more like an advocate for the client, and therefore would be responsible under traditional rules of lawyer ethics.³⁰¹ As opining counsel, the lawyer additionally should be subject to the constraints discussed in this article. The practical consequence is that opining counsel that also helps structure the transaction is necessarily more exposed to the transaction’s entirety, and thus has more opportunity to come across warning signs. This does not necessarily mean that such counsel will, or should, know everything about the transaction and be able to spot all warning signs. The client, for example, may ask counsel to help structure the transaction subject to certain business assumptions. If these assumptions are reasonable, there is no reason why counsel should not be able to proceed.³⁰² The client also may not tell counsel every facet of how the transaction fits into the company’s larger financial picture. Again, so long as counsel sees a business purpose, counsel should be able to proceed.³⁰³ Where a warning sign is spotted, of course, counsel should be subject to the duties discussed elsewhere in this article.³⁰⁴

This article so far has built and tested a framework for analyzing the duties of lawyers issuing structured-finance opinions. I next examine the extent to which that framework applies to, or informs, the duties of lawyers issuing other types of third-party legal opinions in business and financial transactions (hereinafter, third-party business law opinions).

B. What Constraints Should Bind Other Types of Third-Party Business Law Opinions and the Lawyers Issuing Them?

The framework turns out to have significant applicability to the duties of lawyers issuing any type of third-party business law opinion. This can be seen by re-examining the assumptions and logic of the analysis underlying the framework.

Those assumptions began with the following: structured-finance opinions are technically correct as to the matters they cover, address only bankruptcy-law matters (and make no accounting analysis), and are not intended by opining counsel to achieve misleading accounting results or otherwise mislead the public.³⁰⁵ Similarly, it is reasonable to assume that third-party business law opinions generally are technically correct as to the matters they cover,³⁰⁶ address only legal matters (and make no accounting analysis), and are not intended by opining counsel to achieve misleading accounting results or otherwise mislead the public.

³⁰¹ See *supra* notes 137-138 and accompanying text. Normative analysis of traditional rules for lawyers acting as advocates is beyond this article’s scope.

³⁰² Reasonable business assumptions themselves should not constitute warning signs. See *supra* note 196 and accompanying text.

³⁰³ See *supra* note 198 and accompanying text.

³⁰⁴ See *supra* notes 101-104 & 189-204 and accompanying text.

³⁰⁵ See *supra* notes 118-120 and accompanying text.

³⁰⁶ I later relax the assumption that the legal opinion is correct. See *infra* note 323 and following text.

The reasons that government might impose constraints on third-party business law opinions likewise appear similar to the reasons that government might impose constraints on structured-finance opinions. Except to the extent already bound up with market efficiency or externalities, third-party business law opinions are unlikely to impact social welfare, problems of the “common,” allocative fairness, morals, or norms. Paternalism should not be a basis for imposing constraints to the extent, as is customary, the third-party business law opinions are issued in a sophisticated business and finance context.³⁰⁷ Market efficiency should not justify constraints because third-party business law opinions, by reducing information asymmetry, appear to be an efficient means of helping to facilitate business and financial transactions—which, under the social-ordering paradigm, in turn fosters efficiency.³⁰⁸

The principal basis, therefore, for government to impose constraints on third-party business law opinions appears to be, as with structured-finance opinions, to protect against externalities.³⁰⁹ Any time a lawyer issues a third-party business law opinion, the lawyer potentially is creating externalities. If, however, lawyers were constrained from providing those opinions, they would be forced to substitute their judgment about externalities for that of their clients even though, from an information standpoint, their clients generally have more and better information about the consequences of transactions. As in the case of structured-finance opinions, imposing a duty on lawyers to second-guess their clients’ business decisions would be inefficient and probably even unworkable in practice.³¹⁰

This presumes that third-party business law opinions are accurate and thus do not distort transactional arrangements. That is a reasonable presumption because most such opinions are considerably less complex than structured-finance opinions.³¹¹ Moreover, the information failure sometimes associated with structured-finance transactions—the masking of liabilities that only first become evident when a company goes bankrupt³¹²—is not usually associated with other types of third-party business law opinions.³¹³

Subject to these limitations, therefore, lawyers should have the right to issue third-party business law opinions that help facilitate lawful transactions. The two ancillary issues related to issuance of structured-finance opinions still must be resolved, however, in this broader context.

³⁰⁷ See TriBar Opinion Committee, *Third-Party “Closing” Opinions*, *supra* note 55, at 595 (discussing opinion letters in “substantial business transactions”); TriBar Committees, *Legal Opinions to Third Parties: An Easier Path*, *supra* note 47, at 1894 (“legal opinions are . . . an integral and appropriate part of a wide variety of corporate, commercial and financing transactions”) This article will assume such a sophisticated context, recognizing there may be differences in the rare cases where such opinions are issued outside of that context.

³⁰⁸ See *supra* notes 153-154 and accompanying text.

³⁰⁹ This article’s examination of the extent to which externalities caused by third-party business law opinions justify constraints is, as with structured-finance opinions, tempered by the recognition that opinion-giving externalities are different from the externalities resulting from traditional lawyering because the opining lawyer’s goal—to accurately predict a given legal state by applying law to fact—is closer to accounting goals than to the goals of traditional legal advocacy.

³¹⁰ See *supra* notes 158-159 and accompanying text (discussing why lawyers are ill-trained to assess and weigh the costs and benefits of business transactions being facilitated by their opinions).

³¹¹ See *supra* note 31.

³¹² See *supra* note 160 and accompanying text.

³¹³ Outside of the structured-finance context, there generally are no dual-information problems.

The first such issue was whether, in assessing lawfulness, attorneys should examine the entire transaction or just the portion thereof relating to the opinion.

Although attorneys ideally should examine an entire transaction, from a cost-benefit standpoint that appears unwarranted if only a portion of the transaction need be examined to render the requested opinion.³¹⁴ As before, there are at least two ways to curtail externalities without requiring counsel to examine the entire transaction. A minimalist approach is to permit counsel to assume legality if the portion of the transaction relevant to their opinion is lawful and, in the course of preparing due diligence for their opinion, they do not spot warning signs putting them on notice of problems. Where, however, they do spot warning signs,³¹⁵ they should investigate further before issuing their opinion. The other approach is to supplement the minimalist approach by requiring opining counsel to obtain, in appropriate cases as part of their due diligence, an opinion from in-house counsel that the overall transaction does not violate law. As before, I am agnostic as to whether the minimalist approach always should be supplemented in this manner.³¹⁶

The other ancillary issue concerns the meaning of lawfulness in a world of changing laws and norms. Because this article's analysis of that issue does not turn on anything unique to structured-finance opinions,³¹⁷ such analysis should be applicable to any third-party business law opinions. Applying that analysis, lawyers should have the right to issue third-party business law opinions that facilitate transactions that do not violate positive law (although if a transaction nonetheless violates norms, exercise of that right may be risky as a practical matter), and retroactivity should not be used as a basis to impose liability on opining lawyers.

Based on the foregoing, it is possible to articulate at least a beginning framework for analyzing the duties of lawyers when issuing third-party business law opinions.³¹⁸ Lawyers should have the right to issue such opinions to help facilitate lawful business and financial transactions. Lawful means that neither the lawyer's opinion-giving nor, to the extent set forth below, the transaction being opined on is either illegal or unethical as a matter of positive law at the time the opinion is issued. In assessing whether a transaction is lawful, the lawyer should examine at least the portion thereof relating to the opinion. If in the course of that examination the lawyer spots warning signs, the lawyer should investigate further before issuing the opinion. In appropriate cases, the lawyer may want to obtain, as part of the due diligence investigation, an opinion from in-house counsel stating that the overall transaction does not violate law. Failure of in-house counsel to render such an opinion would signal a problem.

³¹⁴ This view is increasingly realistic as outside lawyers specialize further and companies bring more of their day-to-day work in-house. *See supra* note 188 and following text.

³¹⁵ The question of what constitutes warning signs is discussed *supra* notes 193-204 and accompanying text. That discussion should apply to any type of third-party business law opinion.

³¹⁶ *See supra* note 207 and accompanying text (observing, among other things, that requiring a no-violation-of-law opinion would be costly and inconsistent to some extent with the existing norm that companies have no *de novo* obligation to retain counsel when engaging in business transactions, and would not be a panacea).

³¹⁷ *See supra* notes 209-244 and accompanying text.

³¹⁸ I refer to this as a beginning framework only because, outside of the structured-finance context, its assumptions (that the opinions are technically correct, address only bankruptcy-law matters, and are not intended to mislead the public) may be somewhat limiting.

These duties parallel the duties of a lawyer issuing structured-finance opinions.³¹⁹ To understand how these duties³²⁰ would apply, consider a typical third-party business law opinion—a remedies opinion from a borrower’s law firm to the lender, concluding that the loan agreement is enforceable against the borrower.³²¹ For illustrative purposes, assume the borrower intends to use the loan proceeds to acquire another company and then attempt to increase that company’s efficiency by shutting down various of its divisions and business lines, thereby eliminating thousands of jobs.³²²

Because lawyers should have the right to issue third-party business law opinions that help facilitate transactions that are not unlawful at the time the opinion is issued, this opinion should not be subject to criticism and the lawyer issuing it should not be subject to liability. This assumes the lawyer examines at least the portion of the loan transaction relating to the opinion. In the case of a remedies opinion, this means that the lawyer should examine the loan agreement and also either independently establish or rely on in-house counsel to establish that all of the conditions necessary under contract law for the formation of a contract (e.g., execution, delivery, consideration) have occurred and that the borrower validly exists in good standing and has validly authorized the loan agreement’s execution.³²³ If, in the course of doing this diligence, the lawyer spots appropriate warning signs and does not investigate further, the lawyer would be amiss even if the remedies opinion were ultimately technically correct.

Even if we relax the assumption that the third-party business law opinion is technically correct, this statement of an opining lawyer’s duties should continue to apply by recognizing existing liability standards for rendering incorrect opinions. Assume, for example, that opining counsel intends to give a correct opinion but is negligent. Negligence law and lawyer liability thereunder already provide a significant incentive to motivate opining counsel to strive for a correct opinion. Reputational cost provides an important additional incentive. And, in cases where those incentives fail, damages assessed against opining counsel ought to compensate the lender for losses resulting from the incorrect opinion.

CONCLUSIONS

Third-party legal opinions—which are opinions directed not to clients but, at the request of clients, to third parties such as investors or financiers of credit—span the entire range of business and financial undertakings. Indeed, they are of far greater practical importance than opinions directed to clients because they operate to reduce information asymmetry between parties to transactions.³²⁴

The scholarship and authorities governing an attorney’s legal and ethical duties within the adversary legal system focus mostly on advocacy, and provide little guidance for lawyers issuing

³¹⁹ See *supra* note 245 and surrounding text (articulating a framework for analyzing those duties).

³²⁰ That is, the duties of a lawyer issuing a third-party business law opinion.

³²¹ See Silverado Report, *supra* note 55, at 3 (defining a remedies opinion as one concluding that a specified transaction document is enforceable against the client, and clarifying that such opinion is the same as one concluding that such document is legal, valid, binding, and enforceable), at 21-25 (explaining the remedies opinion), and at 45-47 (setting forth an illustrative opinion letter, including the remedies opinion).

³²² This is a variant on the hypothetical discussed *supra* note 159 and accompanying text.

³²³ Silverado Report, *supra* note 55, at 23-24.

³²⁴ See *supra* notes 49-51 and accompanying text.

third-party legal opinions.³²⁵ In that capacity, lawyers do not act as advocates but must strive, in the opinion, for accuracy and fair presentation of legal conclusions. Because lawyers increasingly are being criticized and sued for issuing these opinions, particularly in structured-finance transactions, there is an urgent need for guidance.

This article attempts to derive a normative framework for analyzing the duties of lawyers issuing third-party legal opinions.³²⁶ It begins by examining these opinions issued in structured-finance transactions, assessing existing criticisms and placing those criticisms within the historic debate over a lawyer's public responsibility. The article then engages fundamental principles, demonstrating that the principal rationale for imposing duties in this context is to mitigate potential externalities caused by the opinions. In that connection, the article grapples with and attempts to answer the underlying question of what lawfulness means in a world of changing laws and norms³²⁷ and also explores possible causes of the information failure responsible for such debacles as Enron and other possible misuses of special-purpose vehicles.³²⁸

The article's analysis yields the following framework. Lawyers should have the right to issue opinions that help facilitate structured-finance transactions where the transaction being opined on is neither illegal nor unethical as a matter of positive law at the time the opinion is issued. In making that assessment, the lawyer should examine, as a matter of due diligence, at least the portion of the transaction relating to the opinion. If in the course of that examination the lawyer spots warning signs,³²⁹ the lawyer should investigate further before issuing the opinion. In appropriate cases, the lawyer may want to obtain, as part of the due diligence investigation, an opinion from in-house counsel stating that the overall transaction does not violate law. Failure of in-house counsel to render such an opinion would signal a problem.

This framework recognizes the fundamental difference between monitoring *transactional* lawfulness, whether the transaction itself is intrinsically lawful, and monitoring *corporate* lawfulness, whether the transaction would be lawful if engaged in by the particular client-company. A transaction can be lawful on its face—there is nothing intrinsically unlawful, for example, about accounting transactions that comply with GAAP—but unlawful if engaged in by that company. Because in-house counsel have, or at least have access to, full information of the company, they can more effectively monitor corporate lawfulness.

The article then applies this framework (which is shown to be both explanatory and predictive) to representative transactional scenarios, including the difficult case where a lawyer renders a technically accurate legal opinion for a structured-finance transaction knowing the

³²⁵ Even lawyers' duties arising out of negligence law provide minimal guidance because, remarkably, lawyers issuing third-party legal opinions in structured-finance transactions are criticized and sued *even where* their opinions are technically correct. Critics argue, for example, that technically correct legal opinions may be misleading if they do not fairly present the situation. *See supra* notes 105-114 and accompanying text.

³²⁶ Although this article focuses primarily on the duties of lawyers issuing opinions in, as opposed to structuring, transactions, in principle the article's overall framework should hold even if opining counsel also helps structure the transaction. *See supra* notes 301-304 and accompanying text.

³²⁷ *See supra* notes 209-244 and accompanying text (exploring the disconnects between positive law and norms, as well as disconnects over time (i.e., between positive law applicable at the time an opinion is given and the time of an adjudication)).

³²⁸ *See supra* notes 160-182 and accompanying text.

³²⁹ What should constitute warning signs is discussed *supra* notes 193-204 and accompanying text.

transaction's sole purpose is to achieve off-balance-sheet accounting treatment. Even in this context, the article demonstrates that the lawyer should not generally be subject to liability if the accounting treatment purports to be permitted under GAAP and the company engaging in the transaction is advised by certified public accountants.³³⁰ Finally, the article uses the framework to help inform the duties of lawyers issuing other types of third-party business law opinions.³³¹

This article and its framework are primarily normative. Apart from the framework, any opining lawyer must be cognizant of hindsight bias—the reality that actions, including the issuance of legal opinions, are often judged *ex post* with a critical eye.³³² Thus,

[t]he “nightmare” transaction for any lawyer is representing a client in a transaction that is subsequently held to be fraudulent. . . . Opinion givers properly worry that what they knew when they delivered an opinion letter will be judged with the benefit of hindsight.³³³

Because hindsight bias is exacerbated when emotions are high,³³⁴ the fact that legal opinions are not intended to be guarantees of particular outcomes³³⁵ often can be lost. Indeed, at least some of the criticism of lawyers providing structured-finance opinions may well boil down to the flawed syllogism previously mentioned—the public is harmed; lawyer opinions are a *sine qua non* of the

³³⁰ See *supra* notes 282-288 and accompanying text.

³³¹ Earlier in this article I asked whether the duty to the public of lawyers issuing third-party legal opinions is the same as the duty of an internal government lawyer to the public when writing a legal opinion that advises on the legality of interrogation policies for enemy detainees. See *supra* note 40 and accompanying text. Although not identical, that duty is remarkably similar. In neither case should the lawyer act as an advocate. Lawyers issuing third-party legal opinions should strive to accurately predict a given legal state by applying law to fact, thereby reducing information asymmetry between the parties. See *supra* note 149 and accompanying text. A government lawyer advising on the legality of interrogation policies similarly should strive to render “independent and candid advice.” See David J. Luban, *Selling Indulgences: The Unmistakable Parallel Between Lynn Stewart and the President’s Torture Lawyers* (Feb. 14, 2005) <http://slate.msn.com/id/2113447/> (visited Mar. 2, 2005) (arguing that Yoo and his colleagues “were not acting as courtroom advocates but as legal advisers, with a different professional standard” under Model Ethics Rule 2.1).

³³² Actions judged with the benefit of hindsight often suffer a psychological bias: the human tendency to exaggerate the extent to which an event that has happened could have been anticipated in advance. Jeffrey J. Rachlinski, *A Positive Psychological Theory of Judging in Hindsight*, 65 U. CHI. L. REV. 571, 572 (1998) (“In hindsight, people consistently exaggerate what could have been anticipated in foresight. They not only tend to view what has happened as having been inevitable but also to view it as having appeared ‘relatively inevitable’ before it happened. People believe that others should have been able to anticipate events much better than was actually the case.”) (citing Baruch Fischhoff, *For Those Condemned To Study the Past: Heuristics and Biases in Hindsight*, in JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES 335, 341 (Daniel Kahneman *et al.* eds., 1982); Hal R. Arkes & Cindy A. Schipani, *Medical Malpractice v. the Business Judgment Rule: Differences in Hindsight Bias*, 73 OR. L. REV. 587, 587 (1994) (“Hindsight bias is the tendency for people with knowledge of an outcome to exaggerate the extent to which they believe that outcome could have been predicted.”).

³³³ FIELD, LEGAL OPINIONS IN BUSINESS TRANSACTIONS, *supra* note 56, § 3:9, at 3-14.

³³⁴ See Mitu Gulati *et al.*, *Fraud by Hindsight*, 98 NW. U.L. REV. 773, 774 (2004) (“In the context of securities regulation, hindsight can mistakenly lead people to conclude that a bad outcome was not only predictable, but was actually predicted by managers.”).

³³⁵ See *supra* note 243 and accompanying text.

harm, and lawyers are the only deep pockets; therefore lawyers should be liable for the harm.³³⁶ Lawyers therefore must always be cautious, when giving legal opinions, to try to anticipate changing norms and to conform their conduct (and due diligence) accordingly, always balancing the benefits of these cautions against their costs.

³³⁶ See *supra* note 211 and accompanying text.