KEY POINTS

- Franklin D Roosevelt was right – there are many forms of opinion out there. Legal opinions can be fairly straightforward, for example confirming the capacity of a party to enter into a transaction, or they can require detailed reasoning to underpin complex conclusions.
- Reasoned legal opinions may be required in more complicated transactions and are often essential in securitisations or other structured finance transactions.
- Recent contract law cases have expanded the scope of matters on which "enforceability" opinions may be required.
- Law firms and clients alike should be alive to the scope of reliance upon the opinion and should consider the appropriateness of any associated limitation of liability.

Feature

Authors Andrew Dodds and Estelle Macleod

There are as many opinions as there are experts: issues to consider when drafting reasoned legal opinions

Legal opinions can be complex, and certain areas require the provision of reasoning to support the opining firm's conclusion. Parties should discuss and agree the scope of legal opinions as early as possible within the life cycle of a deal. This article discusses some common areas for consideration.

WHAT IS A LEGAL OPINION AND WHY IS IT USED?

Legal opinions are formal letters typically provided to confirm a specified legal position in relation to a document or a suite of transaction documents.

For example, a firm practising English law may be asked to opine on whether:

- an English company entering into documents governed by foreign law has the legal capacity and authority to enter into a cross-border transaction;
- the English courts would recognise the foreign law selected within the transaction documents and whether a foreign judgment would be recognised by the domestic courts; and/or
- the terms of the transaction documents are legal, valid, binding and enforceable obligations of the relevant parties.

QUESTIONS OF LAW AND FACT

Legal opinion letters typically comprise the opinions themselves, a set of assumptions made in reaching the opinions and a set of qualifications to the opinions. Assumptions largely deal with matters of fact. This is because legal opinions should be limited to matters of law and are not generally designed or required to address questions of fact. There are some exceptions to this, where matters of fact and law are combined, which we touch on below. Qualifications expand on areas of law and are used to qualify the opinions given, for example setting out the circumstances in which an English court might accept or decline jurisdiction. Perhaps unsurprisingly, the assumptions and qualifications in a complicated transaction may constitute the majority of the document.

CLLS GUIDELINES

The City of London Law Society has published a guide to the questions to be addressed when providing English law legal opinion letters in financial transactions (the Guide). The Guide is not binding but it is very useful because, among other things, it suggests questions and highlights key issues which firms practising English law may wish to consider when giving a legal opinion.

WHEN MIGHT A REASONED LEGAL OPINION BE REQUIRED?

Reasoned legal opinions go further than stating the legal position in connection with the transaction. They also set out the legal analysis (usually in the qualifications section) underlying the conclusions made and opinions given. Certain finance transactions (most notably, securitisations or securitisation style financings) require more specific, and potentially reasoned, opinions on areas such as:

- insolvency;
- the nature and effect of security, guarantees and subordination arrangements;
- true sale;
- equities;
- tax;
- security powers of attorney;
- trusts; and
- contractual netting.

Enforceability opinions may need to consider nuanced areas of contractual interpretation, such as agreements to agree and penalty clauses. In such cases, as noted below, the opining firm is likely to need to provide an analysis of the facts as against the legal background.

INSOLVENCY AND SECURITY

The Guide reminds us that in some areas, such as insolvency, it is common practice to include a qualification to the effect that the opinion is subject to the provisions of any insolvency law and other laws affecting creditors' rights generally. However, securitisation transactions often require reasoned opinions on insolvency and security, rendering the opinion letter substantially more complex.

For example, a reasoned opinion may be required as to whether certain of the transactions contemplated by the documents could be contested successfully or avoided or set aside by a liquidator or administrator of the issuer as, for example, transactions at an undervalue or preferences. Such reasoned

opinions will typically be supported by a solvency certificate or statement delivered by the issuer at closing.

In addition, an opinion may be required in relation to whether a qualifying floating charge holder could appoint an administrative receiver in reliance on the "capital markets" exception in the Insolvency Act 1986.

Detailed opinions are also often required on whether security is effective and binding upon any liquidator, administrator or creditor, whether security interests expressed to be created under the security documents take effect as fixed or floating charges and whether any security created falls within the scope of the Financial Collateral Arrangements (No 2) Regulations 2003 (SI 2003/3226).

An opinion on the security position of a transaction may include mixed matters of law and of fact. A firm which has prepared the security documents in connection with a finance transaction might be prepared to opine on any combination of the nature, effect and ranking of such security and whether it is registrable, but this will typically only be possible where the firm has conclusively established priority searches with the relevant registers (for example, with the Land Registry in relation to a legal mortgage over registered land). The scope of the conclusions reached on security will typically be limited, given the complexities of insolvency law. Indeed, to opine on whether the chargor owns an asset over which it purports to create security, a firm would want to have satisfied itself conclusively as to title to that asset, which again is a question of fact.

TRUE SALE AND TAX

In the context of a securitisation transaction, a reasoned legal opinion to confirm whether the transaction constitutes a "true sale" is often required by rating agencies and/or accountants in order for the transaction to proceed.

True sale opinions usually require an overview of the facts which would be used by a court to determine whether the transaction constitutes an outright sale of the receivables (or debts) from the seller/originator to the issuer or is more akin to the issuer incurring a debt obligation and granting security interests (over, among other things, the receivables) to secure that debt obligation. A true sale opinion provides comfort to the transaction parties on this "re-characterisation risk". The opinion allows the parties to assess the risk of whether a liquidator, administrator or creditor of the seller/originator could seek to contest, avoid or have set aside the validity of the "sale" on the basis that it created a security interest which would be void against that liquidator, administrator or creditor for lack of registration under the Companies Act 2006 regime.

A securitisation transaction may also require a reasoned legal opinion on the tax position, including aspects such as whether the issuer will be subject to any withholding or deduction in respect of payments being made under the transaction or liable for the tax of any other party or stamp duty.

EQUITIES AND SECURITY POWERS OF ATTORNEY

In certain finance transactions, reasoned legal opinions may also be required to consider equities which exist on or from the time of the creation of the security interests for the transaction (such as rights of set-off, liens and judicial execution processes) and cross-claims and other dealings as between the seller/originator and the underlying debtor which may interrupt or reduce the transaction cashflows and/or affect the priority of the security created by the issuer. In such instances, the reasoning behind how and why such interests arise may be required.

Parties to a transaction may also require a detailed legal opinion on the validity (and possibly, the irrevocability) of a security power of attorney contained within the transaction documents in order to satisfy themselves that the transaction can proceed as envisaged.

AGREEMENTS TO AGREE, REASONABLE ENDEAVOURS AND CERTAINTY

Firms asked to opine on the enforceability and legal effectiveness of a proposed transaction may need to consider in context fundamental aspects of contract law, such as certainty, the use of "reasonable endeavours" and penalty clauses.

Many agreements use phrases such as "to be agreed between the parties" in an attempt to provide flexibility for matters to be determined in the future. However, as was the case in *Philip Morris v Swanton Care & Community Limited* [2018] EWCA Civ 2763, the courts may find that such a provision (in this case, to extend a period of consultancy "as shall reasonably be agreed") is void for uncertainty.

In *Phillips Petroleum Co UK Ltd v Enron Europe Ltd* [1997] CLC 329, the parties agreed to use reasonable endeavours to agree in advance the dates for gas deliveries. It was held that the buyer was not compelled by this clause to disregard its own commercial interests, and that if that had been the intention, this should have been drafted accordingly. By contrast, in *Astor Management AG v Atalaya Mining Plc* [2017] EWHC 425 (Comm), a provision requiring the parties "to use all reasonable endeavours" to obtain a senior debt facility was held to be enforceable. It was held that, had all reasonable endeavours been used, funds received as equity funding would instead have been provided as a senior debt facility. Lord Justice Leggatt commented in *Astor Management* that whether a party has endeavoured or used best endeavours to reach an agreement "is a question of fact which a court can perfectly well decide".

Accordingly, a reasoned legal opinion may be required to analyse the specific drafting of transaction documents and whether, for example, any provisions allowing for matters to be agreed at another time will be enforceable in light of the facts of the specific scenario. This may require an assessment of whether the contract conclusively determines the way in which such matters will be agreed.

PENALTY CLAUSES

In *Cavendish v Makdessi; ParkingEye v Beavis* [2015] UKSC 67, the Supreme Court replaced the previous test on penalties. The test under the majority judgment in *Cavendish* is "whether the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation". In this context, a primary obligation is one which forms the subject matter of the contract, such as an obligation to pay an amount, whereas a secondary obligation is triggered by the breach of a primary obligation. A penalty clause will always be a secondary obligation.

Biog box

Andrew Dodds is a partner in the Banking & Finance team at Stevens & Bolton LLP.
Email: andrew.dodds@stevens-bolton.com

Estelle Macleod is a professional support lawyer to the Banking & Finance and Restructuring & Insolvency teams at Stevens & Bolton LLP.
Email: estelle.macleod@stevens-bolton.com

In *Makdessi*, the parties had entered into a contract by which Mr Makdessi would sell a stake in his company to Cavendish. The contract contained restrictive covenants, the breach of which would deprive Mr Makdessi of the final two instalments of the purchase price and oblige him to sell his remaining shares at a reduced price (which excluded the value of goodwill). Mr Makdessi breached the covenants but argued that the relevant clauses were unenforceable as penalty clauses.

The Supreme Court held that these clauses were primary obligations and not penalties. Broadly speaking, it was held that the provision constituted a price adjustment and that Cavendish had a legitimate interest in aligning the value of the business, of which goodwill constituted a significant proportion, with its price. A factor in the decision was that the parties were "on both sides, sophisticated, successful and experienced commercial people bargaining on equal terms over a long period with expert legal advice".

In *ParkingEye*, Mr Beavis challenged an £85 fee (which was levied for overstaying the two-hour limit at a car park) as a penalty. The court acknowledged that ParkingEye was not likely to suffer loss as a result of customers overstaying the two-hour period and that the fee constituted a secondary obligation. However, it was not deemed a penalty, in part because ParkingEye legitimately imposed its fees "to encourage the prompt turnover of car parking spaces and also to fund its own business activities and make a profit". The £85 charge was held not to be unconscionable in the context of common parking charges and because motorists entering the car park were given ample warning of the time limit and the amount of the charge.

These cases show that reasoned legal opinions on whether a provision might constitute a penalty clause will be complex and will likely require a commentary on the specific factual position underpinning the transaction in question. More complex still will be an assessment of the proportionality of the potential penalty clause, although the *Makdessi* case suggests that this may not be overly scrutinised where the case involves sophisticated business parties who are taking legal advice.

ORAL VARIATIONS

In *Rock Advertising Limited v MWB Business Exchange Centres Limited* [2018] UKSC 24, the Supreme Court held that a contractual term stating that an agreement could not be amended save in writing signed on behalf of the parties (thus precluding oral variation), was legally effective. Lord Sumption commented in his judgment that "what the parties have agreed is not that oral variations are forbidden, but that they will be invalid" and suggests that the parties overlooked the requirements for a variation. As such, legal opinions may be required to consider the effectiveness of provisions which prescribe methods by which a contract may be varied. In such cases, a firm may well be asked to set out its reasoning along with an analysis of the factual matters at hand in relation to the parties' intentions and/or conduct.

ADDRESSEES, RELIANCE AND LIABILITY

A legal opinion will be addressed to specific addressees, for example, the original lender(s), the arranger(s), the facility agent and the security agent/trustee. Rating agencies will require opinions to be disclosed to them on a rated securitisation transaction and the opining firm will also typically permit disclosure (but no reliance) to other limited categories of people or in specified circumstances, for example where required by applicable law, proceedings or regulation or to the employees, auditors, regulators or professional advisers of an addressee.

In the case of *Haugesund Kommune and another v Depfa ACS Bank* [2009] EWHC 2227 (Comm), the court held that the head of the legal department at the bank in question was "relying on the advice of reputable and highly regarded Norwegian lawyers and he had no reason to question their opinion, which was unqualified", without having to scrutinise the reasoning. That being said, any court's assessment of a party's entitlement to rely on the contents of a legal opinion will be fact specific. The authors do not suggest that parties should choose not to consider the reasons, assumptions and qualifications underlying an opinion.

A legal opinion is just that, an *opinion*. It is given on the date on which it is issued (which is usually the date on which the transaction in question is entered into, although drafts are typically provided and agreed well ahead of completion). There is no obligation to update an opinion after closing as matters develop or if the law changes. A law firm could be liable to its client in negligence in connection with a legal opinion it has provided, but a divergence between an opinion and how a court later treated the matters contained within it would not necessarily indicate negligence by the firm.

A legal opinion represents the judgement made by the opining firm on the legal issues addressed within the opinion. It does not confirm that the transaction is without defect. Equally, opining that a contract is enforceable does not mean that the terms opined upon are not subject to alternative interpretations.

Given the potential liability that can attach to a law firm as a result of providing a legal opinion (especially a reasoned one on a complex transaction), a firm may seek to limit its liability to the relevant addressees or other persons who are permitted to rely on that opinion.

WHAT'S NEXT?

With our departure from the EU looming, many standard form legal opinions will need to undergo amendments, particularly as regards the recognition and enforcement of a decision made in one jurisdiction by another.

We also consider that technological aspects will play an increasing role in legal opinions in coming years. For example, firms may be asked to opine on the validity of security over cryptoassets, or the effectiveness of the electronic execution of documents in cross-border transactions. ■

Further Reading:

- English opinion letters on financial documents: reconciling the UK and US approaches in cross-border transactions (2017) 11 JIBFL 681.
- Legal opinions: what should they cover? (2014) 6 JIBFL 418.
- LexisPSL: Banking & Finance: Practice Note: Providing legal opinions in financial transactions – training materials.