

Report on Selected Legal Opinion Issues in Venture Capital Financing Transactions

By the Opinions Committee, Business Law Section of the State Bar of California

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I. INTRODUCTION

This report (“Report”) is a commentary on customary practice with respect to third-party legal opinions given in venture capital financing transactions (“Venture Financings”), defined for this purpose as equity investments in privately held companies by professional investors. Although the Report sometimes refers to these companies as “venture-backed companies,” this Report is not restricted to the financing of technology companies as such term might imply.

Many opinion letter issues that arise in Venture Financings also arise in other kinds of financing transactions. The Corporations Committee of the Business Law Section (the “Corporations Committee”) addressed these issues as they involve

corporations in its *2007 Business Transactions Report*,² and the Opinions Committee of the Business Law Section (the “Opinions Committee”) addressed issues involving the remedies opinion in its *2007 Remedies Report*.³ This Report supplements the *2007 Business Transactions Report* and the *2007 Remedies Report* by addressing particular opinion letter issues that often arise in Venture Financings. This Report also takes into account positions taken by the TriBar Opinion Committee (“TriBar”) in the *1998 TriBar Report*⁴ and in the *TriBar Preferred Stock Report*.⁵

An objective of this Report is to give opinion practitioners guidance on whether specific opinions are appropriate in Venture Financings. This Report does not prescribe specific forms of legal opinions or the procedures required to give them; however, this Report does provide illustrative opinion letter language. The observations in this Report represent a consensus of the Opinions Committee, but do not necessarily reflect the positions of individual members or their respective firms or organizations.

Readers should evaluate the discussion of legal principles and opinion language contained in this Report in light of any subsequent legislation or judicial decisions and the normal evolution of customary practice.

For convenience, this Report uses the following definitions and conventions in describing opinion practice: (1) following the convention of the *2007 Remedies Report*, the *2007 Business Transactions Report*, and the *1998 TriBar Report*, “opinion giver” refers to the lawyer or law firm in whose name an opinion letter is signed, “opinion preparers” refers to lawyers who prepare an opinion letter, and “opinion recipient” refers to the addressee of the opinion letter and other persons, if any, whom the opinion giver expressly authorizes to rely on the opinion letter; (2) the business entity that is the subject of the opinion (for purposes of this Report, assumed to be a corporation) is referred to as the “Company”; (3) the contracts evidencing obligations of the Company that the opinion addresses are collectively referred to as the “Agreement,” which includes both the singular and plural, as applicable to a specific situation; and (4) the list of contracts that are the subject of specific portions of the opinion are referred to as the “Material Agreements.” As used in sample texts of opinion segments set forth in this Report, capitalized terms refer to the actual corresponding term as defined in the opinion letter itself. For a glossary of the defined terms used in this Report, see Appendix A.

2. CORP. COMM. OF THE BUS. LAW SECTION OF THE STATE BAR OF CAL., LEGAL OPINIONS IN BUSINESS TRANSACTIONS (EXCLUDING THE REMEDIES OPINION) (May 2005) (2007 revision) [hereinafter 2007 BUSINESS TRANSACTIONS REPORT].

3. BUS. LAW SECTION, STATE BAR OF CAL., REPORT ON THIRD-PARTY REMEDIES OPINIONS: 2007 UPDATE (2007) [hereinafter 2007 REMEDIES REPORT].

4. TriBar Opinion Comm., *Report: Third-Party “Closing” Opinions*, 53 BUS. LAW. 591 (1998) [hereinafter 1998 TriBar Report].

5. TriBar Opinion Comm., *Special Report of the TriBar Opinion Committee: Duly Authorized Opinions on Preferred Stock*, 63 BUS. LAW. 921 (2008) [hereinafter TriBar Preferred Stock Report].

II. PURPOSE OF THIS REPORT

Despite their prevalence in California, the third-party opinions given in Venture Financings have not been the subject of any prior report by the Business Law Section. Venture Financings are different from other business transactions in a number of ways that directly affect third-party opinion practice:

- Venture-backed companies often have a limited budget for their counsel, the opinion giver, and the fees of investors' counsel are usually both capped and paid by the Company at the closing of the financing. This imposes a practical limit on the amount of diligence that either the opinion preparers or the opinion recipient can undertake. Tension often results as the opinion giver attempts to limit its opinion to the level of diligence the Company is willing to pay for and the opinion recipient attempts to shift the diligence burden from its own fee-capped lawyers to Company counsel by seeking broad, and sometimes burdensome, opinions.
- Unlike in many other financing transactions in which third-party opinions are given, many substantive business terms in Venture Financings are set forth in non-contractual documents such as the Company's charter. As such, the legal effect of such terms may not derive from the application of contract law principles, but rather from the interpretation of charter provisions under the applicable state law governing the organization of business entities.
- Counsel to a venture-backed company often assists in maintaining the Company's list of shareholders and mechanically processes new issuances, exercises of options and warrants, stock repurchases, and redemptions of stock. This may give the opinion giver a greater knowledge of capitalization matters than might normally be expected of a lawyer. Because this practice is so common, in situations where the Company or a third party acts as the transfer agent, or where the opinion giver newly represents the Company, the opinion recipient may wrongly assume a level of knowledge that in fact the opinion giver does not have.
- Venture Financings are commonly serial in nature (i.e., there is an issuance of securities in each successive round of financing). This means that a legal opinion is normally given on each new round of funding. Often investors (and their counsel) in a new round will expect to receive the same opinions as were given in prior rounds and may resist changes to the opinion language, even though facts or circumstances may have changed over time.
- The boards of directors of venture-backed companies often include, and are in many situations controlled by, existing venture capital investors. This can create an appearance of self-dealing because the board members or their funds have an interest in the terms of each new round of financing and may have been the principal negotiators for the investors in the new round of financing. Due to this possible conflict of interest, some counsel and investors in Venture Financings inappropriately seek a "fiduciary duty

opinion” or similar comfort to an extent not generally seen in other business transactions.

III. IMPACT OF DELAWARE LAW

As noted in the *2007 Business Transactions Report*, the use of Delaware as the state of incorporation for most venture-backed companies has forced opinion givers to consider whether they can give opinions on matters of Delaware law.⁶ Although at one time venture-backed companies often incorporated in California and then reincorporated in Delaware immediately before an initial public offering, today venture-backed companies usually incorporate in Delaware at the outset. The *2007 Business Transactions Report* gives a detailed discussion of concerns with opining on matters regarding the law of a state in which a lawyer is not admitted to practice. That report’s principal conclusions in this regard are (1) lawyers may give third-party opinions on the law of a foreign jurisdiction provided that they have “adequate familiarity” with the relevant law, and (2) while lawyers not admitted in Delaware customarily give opinions on routine questions of Delaware corporate law, they normally do not give opinions on more complex matters or on matters of Delaware commercial or contract law.⁷

Coincident with the trend toward Delaware incorporation is the selection of Delaware law as the law governing the stock purchase agreement and other transactional documents in a Venture Financing. If Delaware law is chosen as the governing law and an enforceability opinion is given, the opinion giver, to avoid the cost of engaging Delaware counsel, may include the following language in the opinion to bridge the gap between the opinion recipient’s request for some comfort and the inability of the opinion giver to address matters governed by Delaware contract law⁸:

6. 2007 BUSINESS TRANSACTIONS REPORT, *supra* note 2, at 87, 91–92.

7. *See id.*

8. Recipients are often willing to accept this opinion rather than requiring the engagement of Delaware counsel. Relevant in this context, and contemplated by the illustrative language, is the internal affairs doctrine, which is that only the state in which a corporation is incorporated may regulate its internal affairs. *See* Matt Stevens, Note, *Internal Affairs Doctrine: California Versus Delaware in a Fight for the Right to Regulate Foreign Corporations*, 48 B.C. L. REV. 1047, 1047–48 (2007); *VantagePoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108, 1113–18 (Del. 2005) (holding that section 2115 of the California General Corporation Law, which provides that certain provisions of California law apply to foreign corporations, was not a valid exception to the Delaware internal affairs doctrine). The sample language carves out of the “as though” opinion those contractual provisions that may be governed by the Delaware General Corporation Law (“DGCL”) by operation of the internal affairs doctrine. Because an opinion letter containing the sample language would also cover the DGCL, the matters governed by the internal affairs doctrine would be covered by such an opinion.

On the other hand, some lawyers are not willing to give such “opinions” because they believe that giving an enforceability opinion on a contract under the law of a jurisdiction that is known not to govern the interpretation of that contract does not provide relevant or meaningful information to the opinion recipient; instead, they believe that local counsel in Delaware (or in another relevant jurisdiction) should be retained to provide the enforceability opinion if the opinion recipient requires it in connection with the transaction.

The Committee believes that any of the approaches described above may be appropriate, depending on the transaction and the opinion policies of the opinion giver.

We note that the [transaction documents] provide that they are to be governed by the law of the State of Delaware. Except with respect to those portions of the [transaction documents] that are governed by the Delaware General Corporation Law, our opinion in paragraph (x) below regarding the validity, binding effect, and enforceability of the [transaction documents] is given as though each of the [transaction documents] were governed by the internal law of the State of California.

IV. SELECTED LEGAL OPINION ISSUES

A. OPINIONS REGARDING CAPITALIZATION

The *2007 Business Transactions Report* provides extensive coverage of capitalization opinions (duly authorized, validly issued, fully paid, nonassessable).⁹ Of relevance to this Report are those matters unique to Venture Financings. Four matters merit comment in this Report.

1. Practical Considerations

Although some venture-backed companies engage third-party vendors to maintain their stock records, these companies often serve as their own stock transfer agents and record keepers, or engage outside counsel (generally the opinion giver) to assist in this function. As such, the Company and its counsel will in most cases have better access to capitalization information than the investor or its counsel. For example, the opinion giver often has access to management, attends board meetings, assists in maintaining corporate records and minutes, and has access to other capitalization data. As such, in general terms a capitalization opinion is a basic, and often appropriate, component of third-party opinions in Venture Financings.¹⁰

Circumstances can arise, however, in which the opinion preparers cannot cost effectively perform the diligence necessary to give an opinion on the type and number of outstanding securities and should not be asked to do so. For example, if an opinion giver only recently has begun representing the Company or did not represent the Company for significant portions of its existence, the opinion giver might reasonably decline to give a capitalization opinion. In such a case, the opinion giver may have no more familiarity with the Company's capitalization than

9. See 2007 BUSINESS TRANSACTIONS REPORT, *supra* note 2, at 65–75.

10. Note that the opinion giver's greater access to information does not necessarily equate to knowledge sufficient to give a capitalization opinion. For example, although access of the kind described above may provide an opinion giver with a great deal of information regarding the Company's capital structure, that information will not necessarily be sufficient to support a capitalization opinion. Opinion recipients, therefore, should not assume that an opinion giver has the requisite knowledge simply by virtue of the fact that it assists in maintaining the Company's stock ledger.

Some opinion givers take the position that, because certain statements in a capitalization opinion are confirmations of fact, they should be included in a separate portion of the opinion letter with other factual confirmations or in a separate letter addressed to the opinion recipient.

investors' counsel and should not be held to a presumed level of access or knowledge that may not exist. Furthermore, the Company's corporate recordkeeping may not be sufficiently organized to permit the opinion giver to give an opinion at reasonable expense and within a reasonable period of time (and perhaps at all). In such cases, the parties should come to an understanding as to whether (a) the Company will fund the diligence required by its counsel to give an opinion, taking the risk that ultimately the opinion giver may decline to give an opinion, or (b) business terms should be adjusted to account for the incremental risk, if any, borne by the investor as a result of not receiving an opinion.

2. Qualifications

Because capitalization opinions are in part confirmations of factual matters, they are in many cases, and in various respects, limited by the opinion giver's knowledge. Often this qualification is simply embedded in the opinion itself (e.g., "to our knowledge, the number of shares of Common Stock issued and outstanding is . . ."). As noted in the *2007 Business Transactions Report*, although such language implies "some lack of factual investigation," what it means "is not entirely clear."¹¹

Several recent cases¹² lend support to the TriBar view that the phrase "to our knowledge" and its variants tell the opinion recipient that the

opinion should not be read literally but rather in the context of customary practice. By doing so, [the opinion giver does] not limit the customary diligence lawyers undertake to support the opinion, and the meaning of the opinion is the same whether or not the phrase is used.¹³

As that report further notes,

The obligation of the opinion preparers to exercise customary diligence in establishing the factual basis for an opinion is implicit in every opinion letter. An opinion giver can limit or disclaim that obligation by including in the opinion letter an express statement describing the factual investigation it conducted on a particular point and making clear that no other investigation was conducted. Often, this is done simply by adding the phrase "without investigation."¹⁴

Consistent with the TriBar approach, some opinion preparers have begun to specify the exact level of diligence undertaken (see examples below). The Committee believes that these limitations are appropriate and should generally be accepted by the opinion recipient.

11. 2007 BUSINESS TRANSACTIONS REPORT, *supra* note 2, at 34.

12. See *Dean Foods Co. v. Pappathanasi*, No. 01-2595 BLS, 2004 WL 3019442, at *12-15 (Mass. Super. Ct. Dec. 3, 2004) (limiting a "no litigation" opinion to the giver's knowledge does not change the meaning of the opinion or the scope of the presumed diligence); *Nat'l Bank of Can. v. Hale & Dorr, LLP*, No. 2000000296, 2004 WL 1049072, at *9-10 (Mass. Super. Ct. Apr. 28, 2004) (limiting a "no litigation" opinion to the giver's knowledge implies that the opinion giver has some degree of superior knowledge that can be actionable).

13. 1998 *TriBar Report*, *supra* note 4, at 619.

14. *Id.*

**Where the Opinion Giver Assists in
Maintaining the Company's Stock Records**

In giving the equity capitalization opinion set forth in paragraph (x) below, we have relied without further investigation on (a) the Company's Amended and Restated Articles of Incorporation filed with the California Secretary of State on [date] (the "Restated Articles"), (b) the bylaws of the Company certified by the Secretary of the Company on [date] (the "Bylaws"), (c) minute books relating to meetings and written actions of the incorporator(s), Board of Directors, and shareholders of the Company, and stock records consisting of [description], that [are in our possession] [have been delivered to us by the Company for the purposes of rendering this opinion], and (d) statements in a certificate the Company has delivered to us relating to the equity capitalization of the Company (collectively, the "Capitalization Records"). We have not undertaken to verify the accuracy and completeness of that information, other than by reviewing the Capitalization Records. Accordingly, our opinion on the number and character of issued and outstanding securities means that, based upon the examination referred to above, the Capitalization Records are consistent with the information as to the number and character of outstanding stock, options, warrants, conversion privileges, or other rights that is set forth in paragraph (x).

**Where the Company or a Third-Party Vendor
Maintains the Company's Stock Records**

With respect to the equity capitalization opinion set forth in paragraph (x) below, please note that we do not maintain any of the Company's stock records. Such records are maintained by [a third-party stock transfer agent ("Agent")] [the Company] and we do not have any control over the procedures used by [Agent] [the Company] for issuing and transferring shares of the Company's capital stock. Accordingly, in giving the equity capitalization opinion, we have relied without further investigation on (a) the Company's Amended and Restated Articles of Incorporation filed with the California Secretary of State on [date], (b) the bylaws of the Company certified by the Secretary of the Company on [date], (c) minute books relating to meetings and written actions of the incorporator(s), Board of Directors, and shareholders of the Company [in our possession] [delivered to us by the Company for the purposes of rendering this opinion], (d) our review of the stock records of the Company maintained by [Agent] [the Company], consisting of [description], (e) statements in a certificate the Company has delivered to us relating to the equity capitalization of the Company, and (f) the attached Certificate of Transfer Agent issued by [Agent] [the Company] as of [date] (collectively, the "Capitalization Records"). We have not undertaken to verify the accuracy and completeness of that information, other than by reviewing the Capitalization Records. Accordingly, our opinion on the number and character of issued and outstanding securities means that, based upon the examination referred to above, the Capitalization Records are consistent with the information as to the number and character of outstanding stock, options, warrants, conversion privileges, or other rights that is set forth in paragraph (x).

3. Rights, Preferences and Privileges of the Preferred

In Venture Financings, the principal business terms (price, liquidation preference, conversion ratios, anti-dilution adjustments, voting power, dividend rights, and redemption rights) are often set forth in the Articles¹⁵ and not in the agreements among the parties. As a business matter, many venture capital investors then seek comfort that the Articles (and the terms of the purchased securities) will be interpreted in the intended manner, and that the rights set forth in the Articles will be given effect by a court. Stated in practical terms, venture capital investors' desire to know that the Articles will "work" has created much debate as to whether this is an appropriate opinion to request, and, if so, how such an opinion should be framed.

Do the Articles "Work"? In general, this opinion request is made in one of two ways: In some cases, the recipient will ask the giver for an opinion that "the rights, preferences and privileges of the stock being purchased in the transaction are as set forth in the Company's Articles."¹⁶ Occasionally, this opinion may also be formulated as a request for an enforceability opinion, i.e., that the Company's Articles are "enforceable against the Company in accordance with their terms."

The Committee believes that both requests are technically incorrect and inappropriate. First, the attributes of the purchased securities are set forth not only in the Articles, but in many other places, such as the applicable corporation statute and case law. Therefore, an opinion that the rights of the shares in question are as stated in the Articles is incorrect because only certain of those rights are set forth in that document. Second, although a corporation's Articles are sometimes said to be a "contract" between a company and its shareholders, a corporation's Articles are not, in fact, a contract as to which a remedies opinion can be given.¹⁷ Instead, the provisions of the Articles relating to the rights of the preferred stock are governed by the relevant corporate law.¹⁸

Supporting Authority. Until 2005, when the initial version of what is now the *2007 Business Transactions Report* was published, it was unclear in California

15. When referring to the organizational document of the Company, the term "Articles" means the articles of incorporation or the certification of incorporation, as the case may be, and all amendments and restatements thereof, including all certificates of determination of the rights, preferences, privileges, and restrictions of outstanding shares or any class or series of shares.

16. "Rights, preferences and privileges" is the articulation set forth in CAL. CORP. CODE § 903 (West Supp. 2009). For Delaware corporations, the request is sometimes formulated as the "powers, designations, preferences and rights" in accordance with DEL. CODE ANN. tit. 8, § 151 (2001).

17. A remedies opinion on the Articles of Incorporation is inapplicable on its face:

A remedies opinion is intended to provide assurances to its recipient concerning the enforceability of the contracts signed and delivered by the parties at or before closing. It addresses whether and subject to what limitations a contract is valid, binding and enforceable against the opinion giver's client. By customary usage, it means that (i) a contract has been formed, (ii) a remedy will be available in the event of a breach of the undertakings in the contract (or the undertakings will otherwise be given effect), and (iii) remedies in the contract will be given effect, unless, in the case of (ii) or (iii), expressly or implicitly excluded.

2007 REMEDIES REPORT, *supra* note 3, at 3 (footnotes omitted).

18. See *TriBar Preferred Stock Report*, *supra* note 5, at 925.

whether any of the customary capitalization opinions could be interpreted to mean that the Company had the ability under applicable law to create stock having the specified rights, powers, preferences and privileges. Both the 1979 *TriBar Report*¹⁹ and the 1998 *TriBar Report* took the position that the “duly authorized” opinion did cover this issue.²⁰ It is possible that the dissonance on this point as between the *California 1982 and 1989 Business Transactions Reports* on the one hand, and the *TriBar reports* on the other, accounts for the prevalence of the “rights, preferences and privileges” opinion request in California Venture Financings. With publication of the predecessor to the 2007 *Business Transactions Report*, California expressly adopted the position taken by *TriBar* that a “duly authorized” opinion confirms that the Company has the power to create stock with the rights, powers and preferences of the shares in question.²¹ As a consequence, a separate opinion that the negotiated rights of the shares in question do not violate applicable legal requirements is duplicative of the “duly authorized” opinion and therefore unnecessary.²² The Committee believes that an opinion recipient should

19. *TriBar Opinion Comm., Legal Opinions to Third Parties: An Easier Path*, 34 BUS. LAW. 1891 (1979) [hereinafter 1979 *TriBar Report*].

20. According to the 1979 *TriBar Report* and 1998 *TriBar Report*, a “duly authorized” opinion means that (1) the corporation had the power to issue the subject shares, (2) the corporation took all corporate action (whether prior to issuance or by ratification) necessary to authorize the issuance of the subject shares, and (3) the corporation had the power under its charter and applicable law to issue shares of the par value, class, and with the rights, preferences, limitations, and other attributes of the issued shares. See 1979 *TriBar Report*, *supra* note 19, at 1909–10; 1998 *TriBar Report*, *supra* note 4, at 648. On the other hand, the *California 1982 and 1989 Business Transactions Reports* only recognized the first two of the foregoing meanings of the “duly authorized” opinion, i.e., that the corporation had the power under its articles of incorporation and bylaws to issue the shares of capital stock at the time they were issued and that the corporation adopted proper resolutions and otherwise took necessary corporate action to authorize or ratify the issuance of the shares. *Comm. on Corps. of the Bus. Law Section of the State of Cal., Report of the Committee on Corporations Regarding Legal Opinions in Business Transactions*, 14 PAC. L.J. 1003, 1049 (1982) [hereinafter 1982 *Business Transactions Report*]; *COMM. ON CORPS. OF THE BUS. LAW SECTION OF THE STATE BAR OF CAL., 1989 REPORT REGARDING LEGAL OPINIONS IN BUSINESS TRANSACTIONS 29* (1989).

21. See 2007 *BUSINESS TRANSACTIONS REPORT*, *supra* note 2, at 67. The report states:

The “duly authorized” opinion means that the Company had the corporate power under its articles and bylaws to issue the shares of capital stock as of the time they were issued. As used in a capitalization opinion, this opinion also indicates that the Company had sufficient authorized shares of each class to cover all outstanding shares as of the time of the issuance of the shares.

As the *TriBar Report* notes, the “duly authorized” opinion also covers whether the applicable state corporation law permits shares having the characteristics of the shares of capital stock that are the subject of the opinion. Accordingly, the “duly authorized” opinion should not be given as to capital stock if the terms of that stock are prohibited by the GCL.

Id. (footnotes omitted).

22. As noted in the *TriBar Preferred Stock Report*:

A duly authorized opinion is understood as a matter of customary practice to confirm that the Company has the power to create stock with the rights, powers and preferences of the preferred stock in question. Since most corporation statutes contain broad statutory authority to create and issue stock with whatever economic and other terms a corporation chooses, an opinion preparer’s inquiry regarding this point often will be limited to whether any of the specified rights, powers or preferences of the preferred stock violate provisions of the corporation statute or the Company’s

not request either (1) a separate opinion to the effect that the rights, preferences and privileges [of the stock being purchased in the transaction] are as set forth in the Company's Articles, or (2) a quasi-remedies opinion that provisions in the Articles will be "enforceable."²³ Instead, the "duly authorized" opinion provides the opinion recipient comfort that the Company has the power under the applicable state corporation law and its charter to create the preferred stock to be purchased by the investors.²⁴

4. Outstanding and Vested Employee Options

A significant component of the capital structure of most venture-backed companies is the size of the Company's employee stock option pool. For the reasons stated below, the Committee believes that investors ordinarily should not request a "stock option opinion," i.e., an opinion on the number of shares issuable upon exercise of outstanding options and reserved for future issuance under applicable option plans or pools.

Relevance of Option Numbers. In calculating the price per share they are willing to pay, some investors treat as outstanding the number of shares the Company expects to issue pursuant to its employee stock plans during a period of time (one year, for example) following the closing of the financing. To support this calculation, investors often seek detailed information concerning the number of shares (1) issuable upon exercise of all outstanding employee stock options, (2) subject to repurchase at cost upon termination of employee services, and (3) still available

charter. Such a violation might exist, for example, if the preferred stock purports to deny holders voting rights, appraisal rights or inspection rights mandated by the statute. Similarly, such a violation might exist if the preferred stock purports to deny holders voting rights when the charter prohibits non-voting stock or to grant a new class or series priority in liquidation over an existing class or series whose terms prohibit creation of stock with a higher priority. The economic terms of preferred stock, such as liquidation preferences or antidilution clauses, ordinarily do not violate the corporation statute and thus, as long as those terms do not violate the charter, usually do not require an exception.

The duly authorized opinion does not address limitations that derive from sources other than the state corporation statute or the Company's charter, such as other statutes and cases that do not arise under the corporation statute.

TriBar Preferred Stock Report, *supra* note 5, at 923–24 (footnotes omitted).

23. TriBar is in accord:

Opinion recipients sometimes request that the opinion expressly confirm that the terms of the preferred stock do not violate the state corporation statute and the Company's charter The Committee believes . . . that this confirmation is already encompassed within the duly authorized opinion.

Id. at 924.

24. Supplementally, the Committee notes that the published literature provides little guidance on the exact nature of the work required to support an opinion that a company has the power to create the preferred stock in question. In this regard, one resource is the online "filing tips" published by the California Secretary of State. See California Secretary of State, Corporate Filing Tips, <http://www.sos.ca.gov/business/be/filing-tips-corp.htm> (last visited Aug. 30, 2009). Listed there are the most common reasons that Articles are rejected by the Secretary of State for failure to comply with the California General Corporation Law ("GCL").

for issuance under the option plan. Although this information is generally the subject of a representation and warranty in the stock purchase agreement, investors often ask that such information be included in the opinion letter.

Practicalities of Giving the Opinion. Because the number of outstanding options and the number of vested options can change literally from one day to the next, a “stock option opinion” is difficult to give and rarely cost-justified in a Venture Financing. Option numbers can be fluid for a variety of reasons:

- An optionee’s unvested options may expire because the optionee’s employment terminates.
- A terminated optionee may fail to exercise vested options prior to their expiration.
- The optionee’s vested options typically remain outstanding for a time after termination of employment, with the amount of time depending on the reason the optionee’s employment terminated. (Post-termination periods for employee options often vary depending on whether the employee’s employment terminated for cause (typically zero to ninety days), terminated without cause or because of resignation (typically thirty to ninety days), or because of death or disability (typically six months to a year).)
- Some optionees, hoping to achieve a tax advantage, will exercise their vested options shortly before the closing of a new round of financing.
- Additional options may vest each time the closing date changes.
- Management may have been delegated the authority to make grants (later ratified by the board), thus complicating the level and nature of investigation required by the opinion giver.

Monitoring such changes requires significant effort, and the number of shares subject to outstanding options can, and probably will, change soon after the closing of the financing for any one or more of the foregoing reasons. Further, many venture-backed companies track the status of their employee options internally, and the Company’s representation as to the number of available shares should typically be sufficient to satisfy the investors’ need for information.

B. OPINIONS REGARDING PREEMPTIVE RIGHTS

1. Generally

“Preemptive rights”—rights, appurtenant to shares, to purchase any newly issued securities of a Company before they are offered to others—began as a common law doctrine designed to protect the ownership of existing shareholders by requiring that any original issuance by the Company of its shares first be offered to its shareholders. As the doctrine evolved, it became clear that a strict application of preemptive rights would not always be in the best interests of the shareholders, and an assortment of common law exceptions began to develop.²⁵ As a statutory

25. See 1 BALLANTINE & STERLING, CALIFORNIA CORPORATION LAWS § 127.03[8][a], [b], at 7-67 to 7-69 (R. Bradbury Clark ed., 4th ed. 2008) [hereinafter BALLANTINE & STERLING].

matter, section 204(a)(2) of the GCL currently provides that a grant of preemptive rights to subscribe to any or all issues of shares or securities of a corporation is not effective unless the right is expressly provided in the Articles, a requirement with the purpose of eliminating the uncertainty associated with common law preemptive rights.²⁶ In addition, the so-called “quasi-preemptive right” based on a breach of fiduciary obligations continues to exist as a matter of common law in California.²⁷

Investors in a Venture Financing have an interest in knowing whether any existing shareholders or other third parties have rights to acquire the securities being sold in the financing. Such rights derive from three general sources:

- Rights created by statute to acquire newly issued securities and therefore existing as a matter of law (“Statutory Right(s)”),²⁸
- Rights created in the Articles to acquire newly issued securities (“Charter Right(s)”); and
- Rights created by a contract among the Company and certain shareholders or third parties to acquire newly issued securities (“Contractual Right(s)”).

26. See CAL. CORP. CODE § 204(a) (West 1990).

27. See, e.g., *Sheppard v. Wilcox*, 26 Cal. Rptr. 412 (Ct. App. 1962) (holders of common stock were held to “have quasi-preemptive rights” when a board controlled by holders of preferred stock preferentially issued such holders enough common stock to wrest control of the corporation from the common). *Schwab v. Schwab-Wilson Mach. Corp.*, 55 P.2d 1268, 1269 (Cal. Ct. App. 1936) (“While stockholders have no pre-emptive right to subscribe to new issues of stock . . . , nevertheless they have the right to demand that directors and officers of the corporation do not use their positions for their own personal advantage, or to discriminate between stockholders, or to so cause stock to be issued as to make a profit for themselves or to obtain or retain control of the corporation.”). However, this “right” is really just an articulation of the general fiduciary duty of the board as such applies to the issuance of shares:

[Although preemptive rights have been abolished in California unless expressly provided in the Articles, California] cases have referred to the survival of what they mislabel a “quasi-preemptive right.” Actually, these cases are only illustrations of the general proposition that the directors and officers of the corporation owe a fiduciary duty to all of the shareholders. This fiduciary duty applies in the case of the issue and sale of shares of stock of the corporation in the same manner that it applies in connection with any other corporate transaction.

HAROLD MARSH, JR., R. ROY FINKLE & LARRY W. SONSINI, *MARSH'S CALIFORNIA CORPORATION LAW* § 7.12, at 7-71 to 7-72 (4th ed. 2004) [hereinafter *MARSH'S CALIFORNIA CORPORATION LAW*]. Another treatise states:

[The] directors' duties . . . preclude them from offering securities in an unfair manner either to themselves or other insiders or to nonaffiliated persons at a price or upon terms that unfairly dilute the existing shareholders in a material respect or that do not otherwise provide the optimum results in cost of capital to the corporation. The duty of directors not to use their own position for personal advantage has created a shareholder's right to demand adherence thereto. This right is referred to as a “quasi-preemptive right.”

1 BALLANTINE & STERLING, *supra* note 25, § 127.03[8][b], at 7-69.

28. Although the GCL does not provide for Statutory Rights as of the date of this Report, other jurisdictions may.

There are many differences among such rights (collectively referred to as “Preemptive Rights”). Statutory Rights and quasi-preemptive rights²⁹ apply as a matter of law. Charter Rights are customized for a particular corporation in its charter documents. Stock issued in violation of Statutory or Charter Rights may be void or voidable as a matter of corporate law. Contractual Rights, on the other hand, are as varied in form and substance as the business principals who create them.³⁰ Failure of the Company to comply with Contractual Rights gives rise to contract remedies, such as damages. Thus, compliance with Preemptive Rights may be an appropriate topic for a third-party legal opinion, but compliance with quasi-preemptive rights is not.

2. Special Issues Relating to Preemptive Rights

The “No Outstanding Preemptive Rights” Opinion. An opinion regarding Preemptive Rights requires the opinion preparers to read the statute, charter documents, and identified contracts in which these rights might be created and, if they are, to reach a legal conclusion as to their applicability to the subject transaction. In Venture Financings, opinion givers in the past have often provided negative assurance regarding the existence of Preemptive Rights.³¹ The Committee believes that, going forward, a different approach is warranted because the “validly issued” opinion is now understood, as a matter of customary practice, to address the existence or non-existence of Statutory Rights or Charter Rights. As noted in the 2007 *Business Transactions Report*, “[t]he ‘validly issued’ opinion confirms that issuance

29. As an expression of the “right” of shareholders to demand adherence by the directors to their fiduciary duty, the Committee believes that a request for an opinion regarding quasi-preemptive rights is inappropriate. Because an opinion on compliance with quasi-preemptive rights is not implicit in an opinion on Charter Rights (or any other similar opinion), no disclaimer is necessary. The Committee believes, however, that an opinion giver could reasonably state expressly that it is not giving an opinion on quasi-preemptive rights to avoid confusion on this point. An opinion recipient should not object to such a statement. *See supra* note 27. *See also* 2007 BUSINESS TRANSACTIONS REPORT, *supra* note 2, at 68–69 (“The ‘duly authorized’ opinion does not address issues related to the compliance by the Company’s directors with their fiduciary duties. Some California lawyers expressly qualify their ‘duly authorized’ opinions by stating that they do not address compliance with fiduciary duties. That qualification is not necessary because it is customarily understood that compliance with fiduciary duties is not covered by an opinion unless specifically addressed.”); *id.* at 71 n.224 (“The valid issuance opinion does not, therefore, address whether the issuance of shares violates the shareholders’ so-called ‘quasi-preemptive’ rights.”).

30. Common examples include rights of “first offer,” rights of “first refusal,” and rights to “maintain percentage interest.”

31. A typical opinion (generally included in the body of the capitalization opinion) would have read as follows:

To our knowledge, except as described above, there are no other presently outstanding preemptive rights set forth in the [Articles], [Bylaws], or [Material Agreements] or rights to purchase from the Company any of the authorized but unissued stock of the Company other than (a) the conversion privileges of the Company’s Preferred Stock, [and] (b) any options that may have been granted under the Stock [Option] Plan [and (c) the rights of first refusal set forth in Section ___ of the Investors’ Rights Agreement] [include others as appropriate, e.g., convertible promissory notes].

of the shares complied with the requirements set forth in the articles and bylaws (including any preemptive rights contained in the articles) and with the requirements of the GCL.”³² As a result and in light of the general disfavor of negative assurance opinions,³³ the Committee believes that a separate opinion on such topics is both redundant and unnecessary.

On the other hand, separate coverage of the existence of identified Contractual Rights is appropriate.³⁴ Two questions remain: (1) what contracts should the opinion giver be expected to review, and (2) is a separate opinion on this topic necessary or is it more appropriately handled in the context of the “no violation” opinion.³⁵

Regarding the first question, in some cases, the opinion giver will have drafted the contracts at issue and already will be familiar with their terms. In other cases, however, the opinion giver may not have drafted them, may have an attenuated or new relationship with the Company, or would have to conduct a significant investigation to identify the types of contracts most likely to contain Contractual Rights. Often such rights are articulated in commercial agreements independently negotiated by the Company, rather than in corporate finance documentation. Increasingly in Venture Financings, the opinion giver and the opinion recipient agree on a list of contracts that the opinion will cover. The opinion on Contractual Rights is then expressly limited to those contracts. Consistent with the conclusions of the *2007 Business Transactions Report*,³⁶ the Committee favors this

32. 2007 BUSINESS TRANSACTIONS REPORT, *supra* note 2, at 69.

33. See generally Task Force on Sec. Law Opinions, Comm. on Fed. Regulation of Sec., ABA Section of Bus. Law, *Special Report: Negative Assurance in Securities Offerings (2008 Revision)*, 64 BUS. LAW. 395 (2008) [hereinafter *Negative Assurance Report*].

34. See 2007 BUSINESS TRANSACTIONS REPORT, *supra* note 2, at 71. The report states:

[A]n opinion that shares have been “validly issued” cannot be given if their issuance violates preemptive rights set forth in the Company’s articles. However, the “valid issuance” opinion should not be understood to address whether the issuance resulted in a breach or default under any contract to which the Company is a party, such as a shareholders’ agreement. Even in the event of such a breach or default, the opinion giver may still render an unqualified opinion regarding the valid issuance of shares. A recipient desiring an opinion on whether shares were, or will be, issued in violation of contractual rights should request an opinion specifically addressing that question.

Id. (footnotes omitted).

35. See *id.* at 50. The report states:

The “no violation” opinion with respect to [a list of specific agreements] is intended to provide the opinion recipient with the comfort that neither the execution and delivery by the Company of the [transaction documents] nor the performance by the Company of the terms of the [transaction documents], including future obligations, breaches or constitutes a default under [the listed agreements]. The opinion means that, as of the date of the opinion, the agreement of the Company to perform future obligations does not breach or constitute a material default of the [listed agreements] and that the mere passage of time would not result in such a breach or default if the Company performed those obligations under the [transaction documents].

Id.

36. See *id.* at 50–51.

approach. By contrast, the Committee believes that a request for negative assurance as to the absence of Contractual Rights is inappropriate even if qualified by a knowledge limitation.³⁷

Regarding the second question, although the negative assurance formulation has been used in the past,³⁸ the Committee believes that the appropriate practice is to treat the Company's compliance with Contractual Rights within the context of a traditional "no breach or default" opinion.³⁹

The "Waiver of Preemptive Rights" Opinion. Sometimes an opinion recipient will also request an opinion that all Preemptive Rights have been effectively waived or satisfied. To give such an opinion, the opinion preparers customarily review (1) the Preemptive Rights provisions, (2) any provisions controlling waiver and amendment of such rights, and (3) any documents entered into by the holders of the Preemptive Rights to identify that the requisite approvals, consents, waivers, and other documents have been received by the Company from the number of rights holders that are required by the Preemptive Rights provision and applicable law. Generally, the opinion preparers have no reasonable way of knowing or determining if the person delivering a waiver has actual, apparent, or no authority to exercise that right and, therefore, as a matter of customary practice, can assume without so stating that the documents reviewed are binding upon the parties. In the Preemptive Rights context, rights may often be waived or amended by less than all of the holders of such rights. Such a "majority rules" regime is subject to laws regarding freeze-outs and similar legal theories involving the duties of majority shareholders to minority shareholders, and it may be unclear whether such a regime violates such laws. Due to this uncertainty, if this opinion is given, the opinion giver often, and appropriately, expressly assumes compliance with the terms of the subject document.⁴⁰ As a matter of customary practice, the opinion is understood not to cover self-dealing, breach of fiduciary duty, or the like by majority holders who have waived or amended Preemptive Rights on behalf of the smaller holders.

C. OPINIONS REGARDING COMPLIANCE WITH FEDERAL AND STATE SECURITIES LAWS

The 2007 *Business Transactions Report* provides extensive coverage of federal and state securities law opinions.⁴¹ Of relevance to this Report are matters common to Venture Financings.

37. If the opinion giver knows of an existing Contractual Right, however, it cannot give a misleading opinion.

38. See *supra* note 31. See also 2007 BUSINESS TRANSACTIONS REPORT, *supra* note 2, at 15–18 (discussing risks inherent in giving a negative assurance opinion).

39. See *supra* note 35.

40. The subject document could be a contract, the Company's Articles, or the Company's Bylaws.

41. See 2007 BUSINESS TRANSACTIONS REPORT, *supra* note 2, at 76–86.

1. Integration of Offerings

Venture Financings are typically serial. There may be multiple closings of one round of financing, and there may be multiple rounds of financing (Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock, etc.). Venture Financings are normally not registered or qualified under applicable federal and state securities laws in reliance on an exemption.⁴² For a Venture Financing to be exempt from registration or qualification, every offer and sale made in connection with the financing must comply with the terms of a single exemption. If two or more Venture Financings are treated as one offering for securities law purposes (i.e., if they are “integrated” into one financing), the integrated financing must comply with the terms of a single exemption. If the integrated financing as a whole does not comply with a single exemption, all the component financings may violate the registration and qualification requirements of the federal and state securities laws, thereby giving each investor in each component financing a rescission right as a matter of law.⁴³ Integration thus becomes a significant issue in Venture Financing transactions.

Investors’ counsel, who do not deal with the Company between financings or who may be representing investors in the current financing for the first time, may lack the access to information and management usually afforded the opinion giver. As such, the opinion giver often is in the best position to review integration issues and make determinations, based upon information received from the Company, as to whether integration creates a rescission right in favor of prior purchasers or could result in potential penalties assessed against the Company by the U.S. Securities and Exchange Commission (“SEC”) or a state securities commission.

Consistent with the *2007 Business Transactions Report*,⁴⁴ the Committee believes that giving an opinion that the subject financing is exempt from registration or

42. A financing structured as a recapitalization under section 3(a)(10) of the Securities Act of 1933 (“Securities Act”), 15 U.S.C. § 77c(a)(10) (2006), would be one counterexample, where qualification under state securities law is involved.

43. See Integration of Abandoned Offerings, Securities Act Release No. 33-7943, 66 Fed. Reg. 8887, 8888 (Feb. 5, 2001). The release states:

The integration doctrine provides an analytical framework for determining whether multiple securities transactions should be considered part of the same offering. This analysis helps to determine whether registration under Section 5 of the Securities Act is required or an exemption is available for the entire offering. The integration doctrine, which has existed since 1933, prevents an issuer from improperly avoiding registration by artificially dividing a single offering so that Securities Act exemptions appear to apply to the individual parts where none would be available for the whole. Improper reliance on an exemption can harm investors by depriving them of the benefits of full and fair disclosure or of the civil remedies that flow from registration for material misstatements and omissions of fact. Whether particular securities offerings should be integrated calls for an analysis of the specific facts and circumstances.

Id. (footnotes omitted).

44. See *2007 BUSINESS TRANSACTIONS REPORT*, *supra* note 2, at 82. The report states:

To be certain that the exemption from federal registration or California qualification is available in a particular transaction, the opinion giver must determine that the transaction is not part of

qualification under the securities laws includes an opinion that the subject financing will not be integrated with prior rounds of financing (or, if integrated, that the integrated financing will be exempt).⁴⁵ On the other hand, the Committee believes that requests for *forward-looking* opinions in this regard—opinions that the subject financing will not be integrated with future offerings—are inappropriate because the opinion giver cannot determine that future rounds of financing (or even future closings of the same round) will not be integrated with the current transaction. The opinion giver cannot know the circumstances that may exist at the time any future closing or offering takes place.⁴⁶

2. “Historical Compliance with Securities Laws”

The Company’s historical compliance with securities laws is a matter of concern for investors who want to be sure that the funds they invest will not be used to repay prior investors exercising rescission rights but rather to finance future growth of the Company’s business. As a result, investors sometimes request an opinion to the effect that “all of the Company’s outstanding securities have been issued in compliance with federal and state securities laws.”

other offers or sales of securities that, taken together, would not qualify for the exemption. These requirements often involve mixed questions of law and fact. The opinion giver will typically rely upon officers’ certificates and may review the Company’s minute book and stock book in an effort to substantiate the factual basis for the determination of whether there are other transactions that may have to be “integrated” with the current offering.

Id. (footnotes omitted).

45. In giving an “exempt from federal registration” opinion, the opinion giver customarily reviews prior sales for an available safe harbor exclusion from integration with reference to the customary five factors:

A determination whether an offering is public or private would also include a consideration of the question whether it should be regarded as a part of a larger offering made or to be made. The following factors are relevant to such question of integration: whether (1) the different offerings are part of a single plan of financing, (2) the offerings involve issuance of the same class of security, (3) the offerings are made at or about the same time, (4) the same type of consideration is to be received, (5) the offerings are made for the same general purpose.

What may appear to be a separate offering to a properly limited group will not be so considered if it is one of a related series of offerings. A person may not separate parts of a series of related transactions, the sum total of which is really one offering, and claim that a particular part is a nonpublic transaction.

Non-Public Offering Exemption, Securities Act Release No. 33-4552, 27 Fed. Reg. 11316, 11317 (Nov. 27, 1962).

If there have been sales that the opinion giver believes may be integrated, the opinion giver then considers whether the offering will be exempt from registration after being integrated with those prior sales. However, when the Company has changed its securities counsel, the investor ordinarily should not expect the opinion giver to give an opinion on stock sales that pre-date the opinion giver’s representation. The opinion giver is normally permitted to make an express integration assumption when not doing so would require the opinion giver to perform an investigation similar to what would be necessary to give an opinion that the prior issuances were exempt from registration.

46. As such, in giving an opinion that an offering of securities is exempt from registration, the opinion preparers customarily assume (without stating) that the Company will not offer or sell securities after the closing in a manner that will be integrated with sales occurring before or at the closing of the offering that is the subject of the opinion.

The Committee believes that such an opinion is overly broad and that requests for it are inappropriate. "Securities laws" include many types of laws, rules, and regulations governing investment advisors, broker-dealers, underwriters, exchanges, investment companies, and others engaged in debt and equity finance, as well as the offer or sale of securities. Further, to give an opinion on past securities laws compliance, the opinion giver would be required to gather the relevant facts surrounding all prior issuances and assess the state of the law in existence at the time they occurred. This task is time consuming and expensive and is rarely, if ever, justified in a Venture Financing.⁴⁷

If investors are concerned about a particular prior stock issuance, they may, to obtain a meaningful opinion, attempt to limit its scope to that issuance. Singling out a particular offering may, however, have unintended adverse consequences for the Company, including regulatory investigations or claims by prior investors. In appropriate cases, perhaps when the Company is newly formed, investors may refine their request to cover particular securities laws and specific offerings, such as the following: "The offers and sales of the Company's capital stock prior to this financing were made pursuant to valid exemptions from the registration requirements of Section 5 of the Securities Act and the qualification requirements of Section 25110 of the GCL." The Committee believes, however, that when this opinion cannot be limited to situations in which the facts can adequately be determined and the opinion can be cost effectively given, the investor should rely on an analysis of its own counsel rather than request an opinion of the opinion giver.⁴⁸

3. Blue Sky Laws

Most venture-backed companies distribute equity to employees and consultants, and sometimes to customers, suppliers, and others. Often a venture-backed Company will have made its first offering of its preferred stock to friends and family, or to "angel" investors. As a result, the Company's shareholders may reside in many jurisdictions outside California.

Practice in California has traditionally involved issuing opinions on blue sky laws of other states based solely upon a review of particular compilations of foreign state blue sky laws. The *Restatement (Third) of the Law Governing Lawyers* states as follows:

Transactional and similar out-of-court representation of clients may raise similar issues, yet there is no equivalent of temporary admission pro hac vice for such representation, as there is in litigation. Even activities that bear close resemblance to in-court litigation, such as representation of clients in arbitration or in administrative hearings, may not include measures for pro hac vice appearance. Some activities are clearly permissible. *Thus, a lawyer conducting activities in the lawyer's home state may*

47. Likewise, consider the complexity of confirming historical compliance with Rule 701, 17 C.F.R. § 230.701 (2009), on which most issuances of stock to employees are based. This might be done, of course, but with an investment of time and money that is not appropriate in most venture capital transactions.

48. See 2007 REMEDIES REPORT, *supra* note 3, app. 4, at 2-9.

*advise a client about the law of another state, a proceeding in another state, or a transaction there, including conducting research in the law of the other state, advising the client about the application of that law, and drafting legal documents intended to have legal effect there. There is no per se bar against such a lawyer giving a formal opinion based in whole or in part on the law of another jurisdiction, but a lawyer should do so only if the lawyer has adequate familiarity with the relevant law.*⁴⁹

Ordinarily, the opinion giver has given an out-of-state blue sky opinion by qualifying its opinions with words to the following general effect:

With respect to the securities laws of _____, we have based our opinion solely upon our examination of such laws and the rules and regulations of the authorities administering such laws, all as reported in [an unofficial compilation]. Neither special rulings of such authorities nor opinions of counsel in that jurisdiction have been obtained.

Although practice in California has in the past often been to give opinions on blue sky laws of other states based solely upon a review of unofficial compilations of foreign state blue sky laws, the Committee believes that the current trend is not to give such opinions. Instead, the opinion giver customarily confirms that the subject financing complies with California state securities law and, in some cases, the securities laws of other jurisdictions in which the lawyers who will participate in preparing the legal opinion have sufficient expertise. The Committee believes this change in practice arises from the recognition that the opinion giver has no expertise on foreign law that investors' counsel does not also have, and each can review the compilations equally as well.⁵⁰

D. OPINIONS REGARDING THE ABSENCE OF LIENS OR ENCUMBRANCES

From time to time, venture investors will request an opinion that, in addition to being fully paid and non-assessable, the shares being issued in the transaction are "issued free and clear of any lien or encumbrance." This type of request (which is not discussed in any current California bar report or TriBar report) is

49. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 3 cmt. e (2000) (emphasis added).

50. More generally, the value of such opinions has been reduced by section 18 of the Securities Act, 15 U.S.C. § 77r (2006), which preempts pre-sale state regulation of offers and sales of securities sold in a transaction exempt from registration pursuant to SEC rules or regulations issued under section 4(2) of the Securities Act, 15 U.S.C. § 17d(2) (2006), other than to require certain notice filings and the payment of a filing fee. The National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (codified in scattered sections of 15 U.S.C.) [hereinafter NSMIA], created the concept of a "covered security," as to which state securities registration requirements were preempted. Securities offered pursuant to the provisions of Rule 506 of Regulation D (promulgated by the SEC under section 4(2) of the Securities Act) constitute one category of "covered security" under NSMIA.

inappropriate due not only to its breadth (“any” lien), but also because there is no reasonable investigation that the opinion giver can conduct to ascertain that no liens or encumbrances, even if carefully defined, are in force. At most, the investors can ask for an opinion that the subject shares are free of any specified liens or encumbrances created by the GCL or by specified contracts that the opinion giver has reviewed.

E. OPINIONS REGARDING THE VOTING OF SECURITIES

1. General

In general terms, a voting agreement is an agreement among shareholders to vote their shares in a specified manner. In the context of Venture Financings, voting agreements typically involve an arrangement by which the holders of preferred stock agree with the principal holders of common stock to vote their shares in a specified manner for the election of directors or as directed by specified investors on other matters. A voting agreement permits shareholders to override the standard one-share-one-vote rules as well as class voting requirements under sections 902 and 903 of the GCL.⁵¹

A drag-along provision is an agreement among shareholders to vote their shares for a proposed acquisition of the Company, or to tender their shares in the acquisition, if requested by specified investors. Thus, drag-along provisions enable a specified group of shareholders to control the voting and/or delivery to an acquirer of all of the shares of the Company, without the need to effect a merger, and to eliminate dissenters’ rights. A drag-along provision may, but need not be, included in a voting agreement.

To distinguish between the two for discussion purposes, this Report uses (i) the term “drag-along agreement” to refer to an agreement among shareholders—whether included as a term in a broader voting agreement or another transaction agreement, or standing alone as a separate contract—to vote their shares in a specified manner in connection with an acquisition of the Company; and (ii) the term “voting agreement” to refer to an agreement among shareholders to vote their shares in a specified manner on any matter other than an acquisition of the Company.

2. Voting Agreements

Current Practice. As stated in the *2007 Remedies Report*,⁵² “[s]ome California opinion givers opine as to the enforceability of voting agreements and the rights contained therein, while others do not . . . largely because the statutory provisions affecting such agreements . . . have remained untested by the California courts. There appears to be no customary practice in this area.”

Until 1997, the GCL (unlike the Delaware General Corporation Law) was silent as to the enforceability of voting agreements, except among shareholders

51. See CAL. CORP. CODE §§ 902, 903 (West 1990 & Supp. 2009).

52. 2007 REMEDIES REPORT, *supra* note 3, app. 10, at B-31.

of statutory close corporations. Prior to 1997, GCL section 706 provided that, for statutory close corporations, voting agreements were specifically enforceable (as opposed to being enforceable merely at law, i.e., by means of an action for damages).⁵³ Although GCL section 706 stated that it did not invalidate any other legal voting agreement, it said nothing else about voting agreements among shareholders of corporations that were *not* statutory close corporations. This created doubt among practitioners as to whether voting agreements among shareholders of corporations that were not close corporations were specifically enforceable. As a result, for many years, California lawyers excluded voting agreements from enforceability opinions in Venture Financings.

Effective January 1, 1997, GCL section 706(a) was amended to expressly authorize written voting agreements among shareholders.⁵⁴ Although this legislative change appeared to permit counsel to give enforceability opinions on voting agreements in California, many opinion givers remained reluctant to do so for at least two reasons:

- The substantive parts of a voting agreement are mutual promises by shareholders to vote in certain ways at certain times. As a result, the Company's obligations are nonexistent or largely ministerial, and an opinion on the Company's obligations under the voting agreement does not give the investors comfort that the voting agreement will be enforced against the shareholders who are parties.
- The remedy that will most likely be sought by an aggrieved investor for breach of a voting agreement is specific performance or injunctive relief, both of which are equitable remedies excluded from the opinion by the equitable principles limitation. As such, an opinion on a voting agreement would not be meaningful to an investor, since the principal remedies sought by the investor would not be covered.

Other Strategies to Obtain an Opinion. To close this gap, some investors have amended their opinion request, as well as the voting agreement itself, in an effort to obtain an opinion from Company counsel that an investor's desired voting outcome will occur.

In some cases, investors' counsel will request an opinion that voting and drag-along provisions "are enforceable against the Company *and the shareholders who*

53. See *infra* note 54.

54. The Legislature amended section 706 to eliminate the references to close corporations, the effect of which was to make section 706 apply to all California corporations. See CAL. CORP. CODE § 706 (West Supp. 2009). In so doing, the Legislature confirmed the result in *Ramos v. Estrada*, 10 Cal. Rptr. 2d 833 (Ct. App. 1992), in which the court upheld a grant of specific performance following a breach of a voting agreement. In *Ramos*, plaintiff Ramos sued defendant Estrada for Estrada's material breach of an agreement to vote her shares in accordance with the decision of the holders of a majority of the shares held by Ramos, Estrada, and three other shareholders. *Id.* at 835. The voting agreement stated that a party's breach of the agreement constituted an election to sell the shareholder's shares pursuant to buy/sell provisions in the agreement. *Id.* at 836. The trial court ordered specific performance of the buy/sell provisions and enjoined Estrada from voting other than as provided in the voting agreement. *Id.* at 835. The court expressly held that the agreement was valid even though it did not create a proxy and the corporation was not a statutory close corporation. *Id.* at 836.

are to be bound.” This request is inappropriate in that it calls for an opinion not on the obligations of the Company (the opinion giver’s client) but of shareholders (who are not the opinion giver’s client). The opinion giver normally would have little or no information about the other parties to these provisions, is poorly positioned to determine if other parties have particular defenses to enforcement, and typically has not received any input from any party other than the Company on the terms of the voting provisions.

Further, in an effort to expand the scope of the remedies opinion so that it is meaningful, some investors’ counsel have added provisions to voting agreements that obligate the Company to enforce them. Some of these provisions vaguely require the Company to use “best efforts” or “all efforts” to ensure that the desired voting result is obtained. Others require specific, affirmative acts by the Company that have in common a contractual duty to force a particular outcome on specified shareholder votes, e.g., a refusal to honor a vote by a shareholder cast in contravention of the voting agreement, a duty to enforce a voting agreement on behalf of an allegedly aggrieved shareholder through appropriate legal process, or a duty to advance or reimburse costs of such enforcement incurred by an aggrieved shareholder party. Even if an opinion on such obligations is not rendered meaningless by the equitable principles limitation, such provisions may violate the GCL⁵⁵ or may be void as a matter of public policy.⁵⁶

For the reasons noted above, the Committee believes that it is inappropriate to ask Company counsel to give an opinion on the enforceability of a voting agreement.⁵⁷

55. Chapters 6 and 7 of the GCL indicate how votes are to be taken and, if taken as specified by the GCL, the vote must be counted. CAL. CORP. CODE §§ 600–711 (West 1990 & Supp. 2009). It is also unclear whether California law permits a prospective waiver of dissenters’ rights, as a drag-along effectively requires. See *infra* Part IV.E.3.

56. Such provisions could also be deemed to perpetuate management control of the Company in violation of public policy, or grant the Company power to vote its own stock in violation of public policy. Under section 703(b) of the GCL, “[s]hares of a corporation owned by its subsidiary shall not be entitled to vote on any matter.” CAL. CORP. CODE § 703(b) (West 1990). With respect to section 703(b), one noted treatise states:

The obvious purpose of these provisions is to prohibit the management of a corporation from voting its shares indirectly so as to perpetuate control of the corporation. They not only frustrate any attempt to establish circular majority ownership but also prevent any voting of shares owned by a subsidiary as defined, which may unfairly influence or determine an election or other corporate action. Although [the GCL prior to the enactment of section 703(b)] contained no such express prohibition, the court in *Lawrence v. I.N. Parlier Estate Co.* (citing *Brewster v. Hartley*) stated that “. . . the rule has long been established that a corporation cannot vote either directly or indirectly, stock of which it is the owner . . . the obvious purpose of which is to secure honesty and fairness in the administration of corporate business.”

MARSH’S CALIFORNIA CORPORATION LAW, *supra* note 27, § 12.07(l), at 12-64 to 12-67 (footnotes omitted) (ellipses in original).

57. Supplementally, this Report does not address the question of whether a lawyer to a shareholder could give an opinion on the enforceability of a voting agreement (that does not include a drag-along provision) as to that particular shareholder.

3. Drag-Along Agreements

Because they are simply a particular type of agreement to vote shares, the Committee reaches the same conclusion as to drag-along agreements—requests for an enforceability opinion are inappropriate. In addition to the legal issues outlined above regarding voting agreements, drag-along agreements may be interpreted to contain a prospective waiver of statutory dissenters' rights such that their enforceability, as a matter of law, is uncertain. The precise question is whether shareholders who enter into a drag-along agreement, by agreeing to “vote in favor” of the transaction within the meaning of GCL section 1300(b), have effectively agreed to relinquish their dissenters' rights. At the time of this Report, the California courts have not addressed this issue, and the Committee believes, therefore, that an opinion recipient should not expect to receive an unqualified enforceability opinion on a drag-along agreement from either Company counsel or shareholder counsel.⁵⁸

4. Conclusion

The Committee believes that an opinion of Company counsel regarding the enforceability of a voting agreement or drag-along agreement is of little or no value to the recipient and should not be requested. To the extent the opinion giver is prepared to give an opinion on the enforceability of voting and drag-along agreements *against the Company*, the Committee believes the following qualifying language would often be appropriate.

This opinion is qualified by, and we give no opinion with respect to, or as to the effect of, any provisions imposing obligations to vote the Company's capital stock in a certain manner, or to comply with any drag-along provision, including without limitation those provisions set forth in the Voting Agreement.

F. OPINIONS REGARDING THE SPECIAL MANDATORY CONVERSION OF SECURITIES

Often referred to as a “special mandatory conversion,” a “pay-to-play” provision specifies the consequences to holders of a specified class or classes of securities (the “Holder(s)”) of not participating in a new financing of the Company. Mechanically, pay-to-play provisions provide that, if any Holder fails to participate in a specified future financing event (a “Triggering Financing”), then the shares of that investor are automatically converted into either common stock or into a new

58. See 2007 BUSINESS TRANSACTIONS REPORT, *supra* note 2, at 18 (“[An] opinion giver should not be asked to render an unqualified opinion on an issue as to which there is significant uncertainty.”).

series of preferred stock that does not include price-based anti-dilution protection or other rights. A pay-to-play provision can be included in the Articles, in which case it will apply to new financings occurring after the provision was added, or it can be effected by contract. The purpose of such provisions is to encourage a particular group of investors to continue to finance the Company by causing any non-participating investor's existing capital to be forcibly converted into an inferior security.⁵⁹

Contractual pay-to-play arrangements are relatively straightforward: the agreement simply provides that shareholders who participate in the Triggering Financing will have the right, when all of the outstanding preferred stock is automatically converted into common stock as a result of the Triggering Financing, to exchange the common stock they receive for a new security of the Company. Some lawyers believe there is a risk of a claim of self-dealing by those who benefit from a contractual pay-to-play event, thereby affecting the enforceability of such agreements. Because a pay-to-play event involves a conversion of shares and therefore a shift in voting power among shareholders, a refusal by a court to give effect to such a provision after it is triggered (regardless of how the provision is structured) would affect a Company's outstanding shares. Some opinion givers include in their opinions an express assumption that the pay-to-play provision was negotiated at arm's length, that the pay-to-play provision was not adopted or implemented by the Company for the primary purpose of perpetuating or increasing the voting control of a controlling shareholder, and that a court hearing the matter would conclude that the subject provision treats all shareholders fairly. Although the Committee believes that an assumption regarding these matters is implicit when not stated, it believes that stating the assumption expressly is not inappropriate.

Inclusion of the pay-to-play feature in the Company's Articles can be more problematic. In such cases, some California opinion givers qualify their opinions on the basis of sections 183 and 400(b) of the GCL, which prohibit any provision that treats the shares of a single series differently from one another.⁶⁰ Whether a

59. See, e.g., Jonathan M.A. Melmed & J. Allen Miller, *Pay-to-Play or No Way*, THE DEAL, Jan. 15, 2008, www.thedeal.com/dealscape/2008/01/payto_play_or_no_way.php (on file with *The Business Lawyer*). Melmed and Miller state:

The justification for pay-to-play provisions is that in a difficult capital-raising environment such provisions are necessary to raise capital and, in some cases, avoid bankruptcy. . . . While there is considerable variation among pay-to-play provisions, they all share the common characteristic that prior round investors in a company are being asked to participate on a pro rata basis in a "follow-on" round of financing or suffer adverse consequences. . . . The adverse consequences of nonparticipation may include the loss of the liquidation preference held by the nonparticipating preferred stockholders, the automatic conversion of such preferred stock into common stock and the loss of company board seats associated with the earlier round preferred stock. From a bottom line perspective, nonparticipation results in potentially heavy dilution of the equity positions held by earlier round preferred stockholders. . . . The traditional justification for pay-to-play provisions is that without the new cash infusion, the company in question will be at risk of going under. As such, the argument goes, the very survival of the company as a going concern ought to trump the nonparticipating stockholders' pre-existing rights as well as any sense of loyalty that the company ought to have toward the original supporters of the venture.

Id.

60. CAL. CORP. CODE §§ 183, 400(b) (West 1990).

pay-to-play provision imposes different conversion rights upon shares of the same series in violation of the GCL remains untested in the California courts, and there appears to be no widely accepted practice in this area.⁶¹ As such, the Committee believes that the use of such a qualification is also appropriate.⁶²

G. OPINIONS REGARDING CONTRACTS ANCILLARY TO THE SALE OF SECURITIES

In addition to the customary agreements that effect the sale of securities in a Venture Financing (e.g., the stock purchase agreement, co-sale agreement, voting agreement, and registration rights agreement), the parties may enter into a variety of concurrent, ancillary business agreements.

For example, some investors may make a venture capital investment in the Company and simultaneously enter into a licensing, development, marketing, or other intellectual property or commercial arrangement. Other investors insist on obtaining a “management rights agreement” from the Company as a precondition to their investment.⁶³

Commercial or intellectual property agreements by themselves rarely involve a request for a third-party legal opinion. As such, a legal opinion on such agreements from Company counsel does not become an important component of diligence for such transactions simply because the commercial or intellectual property agreements are associated with a purchase of securities, and a legal opinion on such agreements would inappropriately shift the diligence burden and related costs to the Company.⁶⁴ Likewise, management rights “letters,” which typically are drafted

61. Delaware courts have considered the validity of pay-to-play provisions twice, in *Benchmark Capital Partners IV, L.P. v. Vague*, No. 19719, 2002 WL 1732423 (Del. Ch. July 15, 2002), and, more recently, in *Watchmark Corp. v. Argo Global Capital, LLC*, No. 711-N, 2004 WL 2694894 (Del. Ch. Nov. 4, 2004), *appeal denied*, 871 A.2d 1127 (Del. 2004) (unpublished table decision). The court in both cases upheld pay-to-play provisions after a fact-intensive analysis focusing heavily on the procedural fairness of the subject provisions (e.g., affected investors were allowed to participate in the new financing, and penalties were exacted pro rata among the non-participating holders).

The consequences of implementing a pay-to-play provision contained in the Articles and subsequently found to be invalid are potentially far reaching. See *Staar Surgical Co. v. Waggoner*, 588 A.2d 1130, 1133 (Del. 1991) (finding that if shares of preferred stock are invalid and void, then any shares of common stock issued upon conversion thereof are likewise invalid and a nullity); *Waggoner v. Laster*, 581 A.2d 1127, 1136 (Del. 1990) (holding that shares issued in violation of a corporation's certificate of incorporation are null and void).

62. Opinion preparers should be aware that a similar qualification may be required in opinions on subsequent sales of the Company's stock. This may be problematic, however, because the qualification may not be acceptable in connection with the later transaction.

63. “Management rights” are contractual rights directly between the investor and an operating company that allow the investor to substantially participate in, or substantially influence the conduct of, the management of the operating company. Such rights are generally articulated in a “management rights” letter agreement between the Company and venture capital fund, and delivered at closing.

64. See 2007 BUSINESS TRANSACTIONS REPORT, *supra* note 2, at 7. The report states:

Lawyers and clients often cite due diligence as the principal reason for requesting opinion letters in business transactions. An opinion letter may be one component of a party's due diligence, but it should not normally be used as a substitute for due diligence performed by the opinion recipient (whether a party to the transaction or a third party that plays a key role in its consummation) and its counsel.

by an investor's counsel to address that investor's internal regulatory concerns (and not to benefit the investors as a whole), are not an appropriate subject of a third-party opinion.⁶⁵ Enforceability opinions in Venture Financings are generally limited to those documents to which all of the investors are parties.

H. NEGATIVE ASSURANCE—"STATEMENTS OF BELIEF"

From time to time an opinion giver is asked to provide a statement that it does not believe that the Company has made any material misstatements of fact (or omitted to state a material fact) in the disclosure document provided in connection with a financing transaction. Such statements are often provided in underwritten, registered public securities offerings and sometimes in unregistered offerings where an agent offers the securities under cover of an offering memorandum.⁶⁶ Negative assurance helps underwriters establish a defense from liability under sections 11 and 12(a)(2) of the Securities Act and placement agents under Rule 10b-5.⁶⁷ Although investors occasionally ask for such opinions in Venture Financings, such requests are not appropriate because the purchasers of the securities are not financial intermediaries with exposure to liability under the securities laws.⁶⁸

65. See *id.* at 13. The report states:

In determining whether a particular opinion is appropriate under the circumstances and, if so, what the nature and scope of that opinion should be, the opinion giver must consider the costs of giving the opinion relative to the benefits to the client of satisfying the request of the opinion recipient.

In many cases, the opinion recipient should be satisfied by its own lawyer's review and advice and should refrain from requesting an opinion from counsel for the other party to the transaction. Moreover, this often is more cost-effective because the lawyer for the opinion recipient usually is more familiar with the documentation.

Id. See also 2007 REMEDIES REPORT, *supra* note 3, app. 4, at 4 (discussing cost-benefit analysis).

66. See *Negative Assurance Report*, *supra* note 33, at 396–97. The report states:

To help them establish the statutory "due diligence" defense in registered offerings, underwriters have long followed the practice of requiring, as a condition to the closing, that counsel participating in the preparation of the registration statement provide negative assurance regarding the disclosures in the registration statement and prospectus. More recently, that practice has been extended to some unregistered offerings (e.g., under Rule 144A or Regulation S) in which an offering document comparable to the statutory prospectus in a registered offering is delivered and the process of preparing it is comparable to that followed in a registered offering. Although §§ 11 and 12(a)(2) of the Securities Act do not apply to unregistered offerings, financial intermediaries and placement agents may request negative assurance to help them establish a defense to claims that might be brought pursuant to Rule 10b-5 under the Exchange Act. The practice of requesting negative assurance has been further extended to some offerings outside the United States.

Id. (footnotes omitted).

67. See Securities Act §§ 11, 12(a)(2), 15 U.S.C. §§ 77k, 77l(a)(2) (2006); Employment of Manipulative and Deceptive Practices, 17 C.F.R. § 240.10b-5 (2009).

68. See *Negative Assurance Report*, *supra* note 33, at 398. The report states:

The purpose of negative assurance is to assist the recipient in establishing a due diligence or similar defense. Therefore, negative assurance is customarily provided only to underwriters or other third parties that can avoid liability in a securities offering by establishing such a defense.

I. ISSUES REGARDING THE FIDUCIARY DUTY OF DIRECTORS, OFFICERS, AND MAJORITY SHAREHOLDERS

By their nature, Venture Financings can raise fiduciary duty issues. Major investors often have designees sitting on the Company's board of directors, and financing terms can frequently provide advantages to those investors at the expense of smaller shareholders. Likewise, whether such transactions are "just and reasonable as to the corporation" (GCL section 310(a)(2))⁶⁹ or "fair as to the corporation" (DGCL section 144(a)(3))⁷⁰ are complex questions of fact well beyond the reasonable scope of any opinion. Further, questions of fiduciary duty by their nature involve an inquiry into the subjective intent of each director or officer. The opinion giver has no reasonable ability to ascertain all relevant facts, both in practical terms and because the opinion giver typically represents only the Company and not any of the directors individually.

Notwithstanding the foregoing, the Committee is aware of a belief among some lawyers that an opinion as to the compliance by the directors, officers, or principal shareholders with their fiduciary duties is appropriate as a stand-alone opinion, or is implicit in the duly authorized opinion, the validly issued opinion, or the enforceability opinion. The Committee believes that such positions are inconsistent with customary practice and prior published opinion reports.⁷¹

Ultimate purchasers of securities, unlike underwriters or other financial intermediaries, do not have liability under the securities laws and accordingly do not need a defense against liability. For this reason, requests to counsel to provide negative assurance to ultimate purchasers, or to issuers, are not appropriate.

Id. (footnotes omitted).

69. CAL. CORP. CODE § 310(a)(2) (West 1990).

70. DEL. CODE ANN. tit. 8, § 144(a)(3) (2001).

71. The duly authorized opinion, the validly issued opinion, and the enforceability opinion do not encompass an opinion as to whether the board or majority shareholders have complied with their fiduciary duties.

Duly authorized. See 2007 BUSINESS TRANSACTIONS REPORT, *supra* note 2, at 68–69. The report states:

The "duly authorized" opinion does not address issues related to the compliance by the Company's directors with their fiduciary duties. Some California lawyers expressly qualify their "duly authorized" opinions by stating that they do not address compliance with fiduciary duties. That qualification is not necessary because it is customarily understood that compliance with fiduciary duties is not covered by an opinion unless specifically addressed. However, there may be circumstances where a California lawyer may include a statement in the legal opinion expressly stating that it does not address such compliance.

Id. (footnotes omitted).

Validly issued. See 2007 BUSINESS TRANSACTIONS REPORT, *supra* note 2, at 71. The report states:

Furthermore, opinions on the valid issuance of the Company's capital stock do not address issues related to the fiduciary duties of directors: that is, where the board action authorizing the issuance is challenged as a violation of the board's fiduciary duties. For example, the sale of shares to insiders in a "down round" financing might be challenged as the product of an improper corporate decision-making process or otherwise as unfair to the Company or its shareholders. Issues related to whether the Company's board of directors complied with its fiduciary duties hinge on questions of fact that generally make the subject unsuitable for coverage in a legal opinion. Opining on fact-intensive matters necessarily means that the opinion giver will have to rely upon elaborate assumptions that substantially impair the value of the opinion and can be very costly.

Because compliance with fiduciary duties is not a matter lawyers can reasonably be expected to address, the Committee believes that it is not appropriate for investors to request an opinion that the directors, officers, or majority shareholders have complied with their fiduciary duties. Conversely, the opinion giver should always be free to state in the opinion that no fiduciary duty opinion is being given.⁷² The following is an example of such a qualification:

We express no opinion as to whether the members of the Company's Board of Directors or officers have complied with their fiduciary duties in connection with their approval of the [transaction documents] or the effect, if any, of any applicable laws regarding (i) the fiduciary duties of majority stockholders or (ii) the rights of minority stockholders with respect to the transactions contemplated by the [transaction documents] or the corporate or other approvals thereof.

Id. (footnotes omitted). See also 1998 *TriBar Report*, *supra* note 4, at 650 ("The validly issued opinion rests on an assumption, customarily unstated . . . that fiduciary duty requirements relating to the issuance have been satisfied.").

Enforceability. See 1998 *TriBar Report*, *supra* note 4, at 47. The report states:

[O]pinion preparers are not required as a matter of customary diligence to inquire into whether those approving the transaction have violated their fiduciary obligations or have an interest they have failed to disclose, unless the opinion expressly covers those issues. The remedies opinion is based on the assumption, usually unstated, that those who have approved an agreement have satisfied their fiduciary obligations and appropriately disclosed any interest.

Id. at 47 (footnotes omitted). See also DONALD W. GLAZER, SCOTT FITZGIBBON & STEVEN O. WEISE, GLAZER & FITZGIBBON ON LEGAL OPINIONS: DRAFTING, INTERPRETING, AND SUPPORTING CLOSING OPINIONS IN BUSINESS TRANSACTIONS §§ 9.3, 10.2.2, at 270–73 n.22, 412–13 n.5 (3d ed. 2008) (discussing further the approaches taken by the 1998 *TriBar Report* and the 2007 *Business Transactions Report* to issues regarding fiduciary duties).

72. Analogous to the fiduciary duty qualification is an assumption that all transactions with officers, directors, and principal shareholders in connection with the Venture Financing meet the requirements of section 310 of the GCL relating to interested transactions and that the transactions are just and reasonable as to the corporation. It is not appropriate for investors to request an opinion regarding such matters, and the opinion giver should be free to assume expressly that such requirements have been met.

APPENDIX A

DEFINITIONS

STATUTES

“1933 Act”

Securities Act of 1933, as amended (codified at 15 U.S.C. §§ 77a–77aa)

“Delaware General Corporation Law”

Delaware Code Annotated Title 8, Chapter 1

“GCL”

California General Corporation Law, Cal. Corp. Code §§ 100–2319

OPINION REPORTS

“1982 Business Transactions Report”

Committee on Corporations of the Business Law Section of the State of California, *Report of the Committee on Corporations Regarding Legal Opinions in Business Transactions*, 14 PAC. L.J. 1003 (1982)

“1989 Business Transactions Report”

Committee on Corporations of the Business Law Section of the State Bar of California, *1989 Report Regarding Legal Opinions in Business Transactions* (1989)

“2007 Business Transactions Report”

Committee on Corporations of the Business Law Section of the State Bar of California, *Legal Opinions in Business Transactions (Excluding the Remedies Opinion)* (May 2005) (2007 revision)

“Negative Assurance Report”

Special Report of the Task Force on Securities Law Opinions, Committee on Federal Regulation of Securities, ABA Section of Business Law, *Negative Assurance in Securities Offerings (2008 Revision)*, 64 BUS. LAW. 395 (2008)

“2007 Remedies Report”

Opinions Committee, Business Law Section, State Bar of California, *Report on Third-Party Remedies Opinions: 2007 Update* (2007)

“1979 TriBar Report”

TriBar Opinion Committee, *Legal Opinions to Third Parties: An Easier Path*, 34 BUS. LAW. 1891 (1979)

“1998 TriBar Report”

TriBar Opinion Committee, *Third-Party “Closing” Opinions*, 53 BUS. LAW. 591 (1998)

OTHER DEFINED TERMS

“Agreement”

The contract or other written instrument evidencing obligations of the Company and pursuant to which the opinion is being given

“Articles”

When referring to the organizational document of the Company, the articles of incorporation or the certification of incorporation, as the case may be, and all amendments and restatements thereof, including all certificates of determination of the rights, preferences, privileges, and restrictions of outstanding shares or any class or series of shares

“Business Law Section”

Business Law Section of the State Bar of California

“Company”

The business entity that is the subject of the opinion

“Corporations Committee”

The Corporations Committee of the Business Law Section of the State Bar of California

“Material Agreements”

The list of contracts and other written instruments that are the subject of specific portions of the opinion

“Opinions Committee”

The Opinions Committee of the Business Law Section of the State Bar of California

“opinion giver”

The lawyer or law firm in whose name an opinion letter is signed

“opinion preparers”

The lawyer(s) who prepare an opinion letter

“opinion recipient”

The addressee of the opinion letter and other persons, if any, whom the opinion giver expressly authorizes to rely on the opinion letter

“Secretary of State”

California Secretary of State

“Venture Financing(s)”

Private equity investments made in privately held companies

“venture-backed companies”

Privately held companies that undertake a Venture Financing

TREATISES

“Ballantine & Sterling”

BALLANTINE & STERLING, CALIFORNIA CORPORATION LAWS (R. Bradbury Clark ed., 4th ed. 2008)

“Glazer & FitzGibbon”

DONALD W. GLAZER, SCOTT FITZGIBBON & STEVEN O. WEISE, GLAZER & FITZGIBBON ON LEGAL OPINIONS: DRAFTING, INTERPRETING, AND SUPPORTING CLOSING OPINIONS IN BUSINESS TRANSACTIONS (3d ed. 2008)

“Marsh’s California Corporation Law”

HAROLD MARSH, JR., R. ROY FINKLE & LARRY W. SONSINI, MARSH’S CALIFORNIA CORPORATION LAW (4th ed. 2004)

“Restatement”

RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS (2000)