Reply

We Are All Saying Much the Same Thing: A Rejoinder to the Comments of Professors Coffee, Macey, and Simon

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I am truly honored that three of the leading luminaries of corporate law, ethics, and legal opinions have read, let alone commented on, my Article. Some of their comments suggest certain differences of perspective and approach. This rejoinder attempts to show how similar, nevertheless, our views really are.

I. Rejoinder to Professor Coffee

In his persuasive and elegant response, Professor Coffee "agree[s] with much that [I] say[] about the insufficiency of a negative externalities standard" but states that he "part[s] company essentially over whether the attorney delivering a third-party opinion has any affirmative obligation to inquire into the transaction's legitimacy."[1] Even "if no warning signals are evident," he argues, legal ethics should mandate a "minimal inquiry . . . into the legitimacy of the specific transaction."[2] By this, he means that the attorney should at least "ascertain that the transaction has a legitimate business purpose."[3]

Less separates our respective positions, however, than Professor Coffee suggests. My Article argues that opining counsel should examine (at minimum) the portion of transactions on which they opine to ascertain lawfulness[4] and that if, in the course of that examination, they spot warning signs, they should investigate further before issuing their opinions.[5] One of my central examples of a "warning sign" is the failure to see a valid business purpose.[6] Thus, Professor Coffee and I are saying essentially the same thing:

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1. John C. Coffee, Jr., *Can Lawyers Wear Blinders?: Gatekeepers and Third Party Opinions*, 84 TEXAS L. REV. 60, 60 (2005).

2. *Id.* at 71.

3. *Id.* at 72.

4. Steven L. Schwarcz, *The Limits of Lawyering: Legal Opinions in Structured Finance*, 84 TEXAS L. REV. 1, 34 (2005).

5. *Id.*

6. *Id.* at 35 (defining a "warning sign" as "failure to see a business purpose in [the] transaction," and referencing Professor Shaun Martin's observation that "if a lawyer can't come up with a good business reason for what she is doing, the lesson [of Enron] is to think twice about it").

counsel should at least have a duty to ascertain that transactions on which they opine have a valid business purpose.

Professor Coffee and I nonetheless appear to emphasize different factors in finding this duty. Coffee focuses on protecting public investors who receive third-party legal opinions.[7] Indeed, a cornerstone of his argument is that "where public investors are the recipients [of legal opinions], legal ethics should seek to protect the opinion-recipient from being reasonably misled (even by a technically accurate opinion)."[8] That argument, however, conflates the investors who are recipients of the legal opinions with the injured public investors. The former are investors in the SPV's securities, the latter investors in the originator's securities.[9] I therefore respectfully disagree with the specific line of reasoning used by Professor Coffee to impose a duty on counsel to ascertain that transactions on which they opine have a valid business purpose (although I find this same duty through a separate line of reasoning).[10]

I do not disagree, however, with Professor Coffee's suggestion that the attorney ascertaining the transaction's business purpose "should be under an obligation to take reasonable affirmative steps to integrate all the knowledge possessed by the attorney's law firm."[11] His rationale is that the law firm, not the individual attorney, renders the opinion. My Article does not address these details, but if it did I would agree with this insight.

It is somewhat unclear whether Professor Coffee and I differ in any substantive conclusions. I argue, for example, that the duty of opining counsel should extend beyond ascertaining that transactions on which they opine have a valid business purpose:

> [If] in the course of preparing due diligence for their opinion, such counsel . . . spot [any] warning signs putting them on notice of problems . . . they should investigate further before issuing their opinion.[12]

Coffee proposes that "the attorney [should] halt in the face of red flags [i.e., warning signs]."[13] He therefore is silent on whether the attorney should go further, as I suggest, to investigate whether the warning signs can be resolved. If he were to focus on it, I believe he would agree with my suggestion.

See also id. at 52 (observing, when applying my Article's framework, that "so long as counsel sees a business purpose, counsel should be able to proceed").

7. Coffee, *supra* note 1, at 68, 73–74.

8. *Id.* at 73–74. *See also id.* at 60 ("This brief comment focuses not on the normal relationship between attorney and client, but on the very different relationship between an attorney who is retained by a client to give an opinion to third parties who will foreseeably rely upon it.").

9. Schwarcz, *supra* note 4, at 22–23.

10. *See supra* notes 4–6 and accompanying text.

11. Coffee, *supra* note 1, at 72.

12. Schwarcz, *supra* note 4, at 34 (citations omitted).

13. Coffee, *supra* note 1, at 72.

Professor Coffee also contends that coupling this duty (to halt in the face of warning signs) with a duty to ascertain that the transaction has a legitimate business purpose would "spare[] everyone the costs of an ex post determination as to whether the attorney culpably missed or ignored warning signals."[14] Such costs would only be spared, however, where the existence of a legitimate business purpose obviates counsel's need to heed other possible warning signs. It is therefore uncertain if Professor Coffee is arguing (as I do) that opining counsel should be alert for warning signs even after identifying a valid business purpose.[15]

The duty of opining counsel to be alert to warning signs may well generate costs (including, as Professor Coffee observes, the costs of ex post determinations). Having practiced law for many years and thus being sensitive to the need to have ex ante clarity, I am sympathetic to Professor Coffee's concern. For this reason, my Article advises that "[c]ourts should . . . exercise caution against finding warning signs where none exist."[16] There will, nonetheless, be residual costs; but such costs appear justified for reasons of professionalism and pragmatism. For the sake of the profession (and one's own integrity), a lawyer cannot simply ignore something that he or she sees, or should see, as a warning sign of a problem. Pragmatically, nothing that Professor Coffee or I say will prevent legal opinions from being judged with hindsight bias if warning signs are missed.[17] It is better that opining lawyers recognize this reality and act accordingly.

Another possible difference in our substantive conclusions is that Professor Coffee suggests that an attorney giving a "true sale opinion, knowing that the auditor will rely on this opinion in permitting the originator to remove liabilities associated with the transferred assets," arguably is "mislead[ing] . . . in the sense of causing [the auditor] foreseeably to reach an erroneous result."[18] In my view, however, there is nothing intrinsically wrong with giving this opinion: in most structured-finance transactions, the sale "transfers risk from the [originator to the SPV] and its investors; and transfer of risk is, and should be, central to the accounting determination . . . ."[19]

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14. *Id.*

15. Schwarcz, *supra* note 4, at 44. For an indication that Professor Coffee may well be arguing as I do, see Coffee, *supra* note 1, at 72 (observing that "a better rule would require the attorney not only to halt in the face of red flags, but also to ascertain that the transaction has a 'legitimate business purpose'").

16. Schwarcz, *supra* note 4, at 35. *See also id.* at 18 ("The trick . . . is identifying what constitutes warning signs: some 'red flags' may be (metaphorically) furled and hard to see, whereas orange flags sometimes might appear red.").

17. *See id.* at 57 (discussing "the reality that actions, including the issuance of legal opinions, are often judged ex post with a critical eye").

18. Coffee, *supra* note 1, at 68–69.

19. Steven L. Schwarcz, *Enron and the Use and Abuse of Special Purpose Entities in Corporate Structures*, 70 U. CIN. L. REV. 1309, 1315 (2002).

In summary, Professor Coffee and I appear to be in general agreement even though we may quibble in certain limited respects.[20]

II. Rejoinder to Professor Macey

Professor Macey examines why a market for third-party—as opposed to simply client—legal opinions exists, and also critiques my "externalities" approach to analyzing the nature and limits of legal opinions. I will consider his comments in that order.

Macey first argues that a market for third-party legal opinions—recall these are "legal opinions . . . provided, at the request of clients, to or for the benefit of third parties such as financiers of credit or investors"[21]—exists because the client's "lawyers can [issue these opinions] more *efficiently* than the lawyers for the third parties."[22] I agree with much of this argument, and indeed find it to be a valuable contribution. I only quibble with Macey's comparison between this argument and what he says is my argument: that the existence of information asymmetries explains the market for third-party legal opinions.[23]

I make no such argument, however. My Article does not attempt to explain *why* the market for third-party legal opinions exists. It simply observes that "[l]awyers providing the opinion apply applicable law to the transaction's particular facts in order to reach their legal conclusions. In this sense, third-party legal opinions operate to effectively reduce information asymmetry between parties to a transaction."[24] This is merely a description of *how* the market for third-party legal opinions operates, not an explanation of why this market, as opposed to a client-opinion market, arose.

This quibble aside, Macey's observations help inform my Article. To understand how, consider two scenarios: the first, a typical third-party legal

20. Additional quibbles include the following. Professor Coffee suggests that rating agencies are not "demanding consumers of legal opinions." Coffee, *supra* note 1, at 63–64. In my experience, though, rating agencies are highly demanding, perhaps because their reputation—by far their most important capital—is at stake any time they accept an opinion that turns out to be wrong. *See, e.g.*, Steven L. Schwarcz, *Private Ordering of Public Markets: The Rating Agency Paradox*, 2002 U. ILL. L. REV. 1, 14, 18 (2002). At another point in his response, Professor Coffee bases part of his arguments on the fact that "the U.C.C. does not draw any distinction between a 'true sale' and a transfer for security where the assets transferred consist of" the types of intangible financial assets underlying most structured-finance transactions. Coffee, *supra* note 1, at 69–70. That, however, appears to conflate commercial law sales and bankruptcy law sales, as did the court in Octagon Gas Sys., Inc. v. Rimmer, 995 F.2d 948 (10th Cir. 1993). *See* PERMANENT EDITORIAL BD. FOR THE UNIF. COMMERCIAL CODE, PEB COMMENTARY NO. 14, at § 9-102(1)(b) (1994) (discussing why these types of sales should not be conflated).

21. Schwarcz, *supra* note 4, at 2.

22. Jonathan Macey, *The Limits of Legal Analysis: Using Externalities to Explain Legal Opinions in Structured Finance*, 84 TEXAS L. REV. 75, 76 (2005).

23. *Id.* at 77.

24. Schwarcz, *supra* note 4, at 10–11.

opinion given by a borrower's law firm to the lender;[25] the second, a set of true sale and nonconsolidation opinions provided to or for the benefit of an SPV's investors by outside counsel to the originator in a structured-finance transaction.[26]

In the first scenario, the third-party legal opinion traditionally covers a range of legal issues, including due authorization, execution, and delivery of the loan agreement, no-violation-of-law, no violation of the borrower's contractual obligations, and enforceability of the loan agreement.[27] Professor Macey's analysis clearly and succinctly explains why the borrower's counsel—and not the lender's—give the first three of these opinions. How the borrower authorizes loan agreements, and whether loan agreements violate laws or contractual obligations applicable to the borrower, are all issues that the borrower's counsel are either already familiar with or must become familiar with in order to advise the borrower.[28] This is the "economy of scope" Macey refers to: combining "the legal work [counsel] do for their clients with the legal work that they do for the third parties."[29]

That explanation does not necessarily explain, though, why the borrower's counsel also issues the enforceability opinion. Quite the contrary, borrower's counsel are generally much less familiar with the loan agreement and its enforceability than lender's counsel because lender's counsel traditionally draft the loan agreement[30] and are also likely to represent the same lender in other loan transactions, thereby becoming familiar with the law applicable to the enforceability of loan agreements.[31] Furthermore, borrower's counsel are always in somewhat of a conflict position when giving an enforceability opinion because their client would prefer that the loan agreement not be enforceable. Thus, counsel zealously representing the borrower would—in a universe lacking professional integrity, reputational costs, and liability rules—prefer to opine that a loan agreement is enforceable when in fact it is not.

One possible explanation why borrower's counsel render the enforceability opinion derives from Macey's argument: because borrower's counsel are already giving the other opinions, it is less costly for them to also give the enforceability opinion, as opposed to requiring lender's counsel to

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25. *Id.* at 9 (using this example to examine the duties of lawyers issuing any type of third-party business law opinion).

26. *Id.* at 5. This is the scenario on which my *Legal Opinions* article primarily focuses.

27. *See* DONALD W. GLAZER & SCOTT FITZGIBBON, GLAZER AND FITZGIBBON ON LEGAL OPINIONS xi–xxiii (1992) (providing an overview of the range of legal opinions).

28. Macey, *supra* note 22, at 81.

29. *Id.* at 76.

30. *See, e.g.*, Kathleen C. Engel & Patricia M. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, TEXAS L. REV. 1255, 1336 (2002) (observing that "the informational advantage that lenders enjoy is compounded by the fact that the lenders design the loan terms and draft the underlying loan agreements and disclosures").

31. *Id.*

gear up to give that single opinion (notwithstanding that lender's counsel, other things being equal, are much better equipped to render this opinion[32]). Two other possible explanations are described in a footnote to my Article: "third-party legal opinions can . . . decrease risks to the recipient [in this example, the lender] by arguably hindering the nonrecipient party's [i.e., the borrower's] ability to 'attack[] the validity of the transaction'";[33] and "third-party legal opinions are an accepted (and sometimes almost mandatory) means of establishing due diligence on the part of a recipient corporation's directors."[34] As a personal anecdote, as a young lawyer I asked a partner at my law firm, Shearman & Sterling, why, as lender's counsel, we always ask borrower's counsel to give enforceability opinions on loan agreements that we draft and intimately know; the partner responded that the opinion from its own counsel might estop the borrower from contesting the loan agreement's enforceability—an explanation similar to that referenced above.[35]

These explanations also partly help explain why a market for third-party legal opinions arose in the second scenario—true sale and nonconsolidation opinions provided to or for the benefit of an SPV's investors by outside counsel to the originator in a structured-finance transaction.[36] A nonconsolidation opinion is highly fact specific to the originator, and therefore Professor Macey's explanation clearly illuminates why originator's counsel, as opposed to investors' counsel, issue it.

A true sale opinion, on the other hand, is fact dependent almost entirely on the document purporting to create the sale.[37] Traditionally, as with loan agreements, investors' counsel draft this agreement and, being likely to represent at least some of the same investors in other structured-finance transactions, are probably more familiar with the law applicable to true sales.[38] That law, indeed, is much more complex and nuanced than the law

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32. *See supra* notes 30–31 and accompanying text (observing that lender's counsel traditionally draft the loan agreement and are also likely to represent the lender in ongoing loan transactions for a variety of borrowers, thereby becoming familiar with the law applicable to the enforceability of loan agreements).

33. Schwarcz, *supra* note 4, at 11 n.55 (cautioning, though, that it is unlikely that a third-party legal opinion would dissuade the borrower from asserting defenses or prevent a court from reaching its own legal conclusions).

34. *Id.*

35. *See supra* note 33 and accompanying text (discussing whether the opinion might hinder the borrower's ability to attack the validity of the transaction).

36. *See supra* note 26 and accompanying text.

37. *See* STEVEN L. SCHWARCZ, STRUCTURED FINANCE, A GUIDE TO THE PRINCIPLES OF ASSET SECURITIZATION §§ 4:2–4:5 (3d. ed. & supps. 2005) (identifying the important factors relevant to true sale determination, all of which are fact dependent solely on the sale documentation). Although true sale determination might be marginally influenced by certain factors pertaining to the originator, such as intent, even that is "evidenced by the documentation" as well as actions. *Id.* § 4:6, at 4-11. To the minimal extent actions may be relevant, investors' counsel could request, as part of the due diligence for their opinion, a fact certificate from the originator.

38. This observation is based mainly on my experience. *Cf.* Engel & McCoy, *A Tale of Three Markets*, *supra* note 30 (observing that lenders draft the loan documentation).

regarding the enforceability of loan agreements, making it even more efficient for investors' counsel to give the true sale opinion. Also, originator's counsel—like borrower's counsel giving an enforceability opinion—are always in somewhat of a conflict position when giving a true sale opinion because the originator may well prefer that the transferred financial assets not actually be sold.[39] The "economy of scope" argument therefore may not completely explain the existence of a market for third-party true sale opinions.

I next turn to Professor Macey's critique of my "externalities" approach to analyzing the nature and limits of legal opinions. Here, after cutting through a great deal of semantic underbrush, we appear to be very much in agreement. The underbrush, however, is thick.

Macey contends, for example, that my Article does not distinguish between externalities that infringe on third-party rights and those that impose costs on third parties. True enough, but that distinction would not appear to advance my analysis, and indeed Macey does not indicate that it would. Macey also suggests my distinction between "lawful externalities" and "unlawful externalities" is circular; but he bases his reasoning *not* on my definition of these terms but on his own, thus inadvertently creating the circularity.[40] Macey also questions whether my Article focuses on "externalities created by a lawyer's third-party legal opinion" or, instead, on "externalities associated with the underlying transactions themselves."[41] These, in fact, are the same externalities because the legal opinion itself does not directly create the externalities but, rather, helps facilitate the transaction that creates the externality.

Macey additionally questions my argument that "if lawyers were constrained from providing opinions to effectuate bargained-for lawful business transactions that nonetheless may cause externalities, they would be forced to substitute their judgment about externalities for that of their clients," which would be bad because "clients generally have more and better

39. *See, e.g.*, SCHWARCZ, *supra* note 37, § 4:1, at 4-4 (discussing LTV Steel Company's challenge to its prebankruptcy structured-finance facilities, arguing that the transfers to the SPVs were not true sales and, therefore, that LTV should be able to use the collections of receivables as "cash collateral" by giving adequate protection under bankruptcy law).

40. Professor Macey disregards my definition of "lawful externalities" (externalities "whose causation is neither illegal nor government-constrained as unethical") and substitutes his own definition ("a lawful externality is an externality that has been made permissible by the government"). Macey, *supra* note 22, at 79. Under my definition, it is an open question whether government *should* constrain the externality. Under his definition, the government has determined that the externality should not be constrained. His definition alone leads to the circularity he criticizes: "*if* a lawful externality is an externality that has been made permissible by the government, then the existence of [this] externality cannot be used to justify government intervention." *Id.* (emphasis added).

41. *Id.* at 80.

information about the consequences of a transaction, other than the transaction's legality."[42]

This is "not quite a complete argument," he asserts, because "clients are likely to have very perverse incentives since it is the *clients* who receive all of the *benefits* from any negative externalities they impose on others."[43] I agree with Professor Macey's observation about perverse incentives. His criticism is misplaced, however, because it does not actually address my full argument. I further argue that "where lawyers facilitate lawful transactions that create problematic externalities, the focus should be not on lawyer conduct but instead on whether to legally prohibit those transactions—or at least subject the companies that engage in them to liability in order to shift the externalities back onto those companies."[44] In other words, the government, not individual lawyers issuing legal opinions, should be responsible for deciding whether to constrain any harmful transactions caused by these perverse incentives.[45]

Although Macey later appears to recognize my full argument,[46] he suggests it would lead to an undesirable consequence:

> [I]f this is the case, then neither lawyers writing third-party legal opinions nor the companies engaged in the transactions that require the generation of such opinions should be expected to engage in any review of the externalities associated with any transaction in which they are engaged, as distinct from their review of the basic legality of the transaction.[47]

His view, however, is a non sequitur. My Article does not purport to address the extent to which *companies* engaged in transactions that require the generation of such opinions should be expected to review externalities associated with such transactions. More germanely, my Article clearly states that opining lawyers should review these externalities to assess potential violations of norms and warning signs.[48]

In short, once one cuts through the tangle of semantics, Professor Macey and I appear to be very much in agreement. He almost admits as much, observing that "[t]his is not to say that I necessarily disagree with Professor Schwarcz's policy conclusions. In fact, I think his observations may well be sound."[49]

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42. *Id.* (quoting Schwarcz, *supra* note 4, at 38).

43. *Id.*

44. Schwarcz, *supra* note 4, at 32–33.

45. And, similarly, that government, not opining lawyers, should be responsible for deciding whether to constrain these incentives.

46. Macey, *supra* note 22, at 81.

47. *Id.*

48. Schwarcz, *supra* note 4, at 34–36.

49. Macey, *supra* note 22, at 80.

III. Rejoinder to Professor Simon

Professor Simon argues that lawyers should not issue legal opinions to assist clients in earnings-management transactions, which he defines as transactions "solely [or dominantly] for the purpose of achieving accounting effects" that make the company's managers look good.[50] He views these transactions as presumptively wrongful because, "even where they do not involve lying or GAAP violations, 'earnings management' activities are at best wasteful and at worst misleading."[51] Thus, the duty not to issue legal opinions to assist these transactions is "most compatible with the idea of lawyering as a dignified calling."[52]

Professor Simon contrasts his view with mine, which, he asserts, takes a more limited stance on when law should impose constraints. In reality, though, Simon and I are not very far apart in our views.

On one level, indeed, we are of the same mind. Simon states that "[a]nother way to frame" his view that lawyers should not issue legal opinions to assist clients in earnings-management transactions "would be to insist that management articulate a prima facie plausible business purpose for an activity with which he asks the lawyer's assistance."[53] My Article, however, proposes this very duty, arguing that counsel should ascertain that structured-finance transactions on which they opine have a valid business purpose.[54]

Even aside from this simplified "framing," Professor Simon and I have largely congruent views. We clearly agree that lawyers should not render opinions to assist earnings-management transactions that are illegal, as a matter of positive law. We also agree, though for different reasons, that lawyers should not render opinions[55] to assist earnings-management transactions that violate norms, even if those norms have not yet been incorporated into positive law.[56]

Professor Simon's rationale for why lawyers should not issue opinions to assist norms-violating earnings-management transactions is ethically principled: lawyers should not participate in conduct that is "socially harmful."[57] Although this is a fine aspirational goal, I hesitate to suggest that individual lawyers, at the risk of liability, should have to decide whether business transactions are socially harmful where society itself has not made

50. William H. Simon, *Earnings Management as a Professional Responsibility Problem*, 84 TEXAS L. REV. 83, 83 (2005).

51. *Id.*

52. *Id.* at 92.

53. *Id.* at 83.

54. Schwarcz, *supra* note 4, at 32–37. *See also supra* notes 4–6 and accompanying text (explaining how this duty arises).

55. Simon, *supra* note 50, at 87–88.

56. Schwarcz, *supra* note 4, at 37.

57. Simon, *supra* note 50, at 88.

that explicit determination.[58] Nonetheless, I conclude that lawyers should avoid opining on norms-violating earnings-management transactions for pragmatic reasons: issuing opinions to assist these types of transactions can hurt the opining counsel's reputation; and when the public suffers losses, it tempts judges to find some basis to hold such counsel liable for the harm.[59]

Professor Simon and I disagree more conceptually, however, on whether lawyers should be able to render opinions to assist earnings-management transactions that are *neither illegal as a matter of positive law nor violative of norms*. He takes the same "principled" position described above: lawyers should not participate in conduct that is socially harmful.[60] In contrast, I do not believe these types of transactions are necessarily socially harmful, as discussed below.[61] Furthermore, even more so than in the preceding paragraph, I believe that individual lawyers should not be forced to decide, at the risk of liability, whether business transactions are socially harmful where society has neither explicitly (as positive law) nor implicitly (as a norm) made that determination.[62]

I recognize, though, that even where a transaction is not illegal or violative of norms, opining counsel ought to remain alert to warning signs of problems.[63] Where they spot warnings signs, such counsel should not issue their opinions unless the warnings signs are favorably resolved.[64] At least since the recent release of an SEC staff report on off-balance-sheet transactions criticizing the use of structured transactions whose sole (or perhaps even primary) purpose is motivated by accounting treatment,[65] the use of structured finance for earnings management may well constitute a warning sign. Accordingly, under my Article's framework, counsel asked to opine on a structured-finance earnings-management transaction should examine the transaction more closely before issuing their opinion.

58. Schwarcz, *supra* note 4, at 19–21. *Cf.* E-mail from Richard W. Painter, Guy Raymond and Mildred Van Voorhis Jones, Professor, University of Illinois College of Law, and newly appointed White House Chief Ethics Officer, to author (Feb. 13, 2005) (on file with author) (observing that although the concept that a legal opinion should fairly present the situation is "sound in principal," it is "notoriously vague if used to impose liability on lawyers" and therefore might serve as a "definition of professionalism, but not as grounds for civil liability").

59. Schwarcz, *supra* note 4, at 37.

60. *See supra* note 57 and accompanying text.

61. *See, e.g.*, *infra* notes 66–67 and accompanying text (explaining why structured-finance transactions used for earnings management need not necessarily be harmful).

62. A lawyer who believes a transaction is personally objectionable always can resign, of course, or not represent the client in the first place.

63. Schwarcz, *supra* note 4, at 236.

64. *See id.* at 34.

65. REPORT AND RECOMMENDATIONS PURSUANT TO SECTION 401(C) OF THE SARBANES–OXLEY ACT OF 2002 ON ARRANGEMENTS WITH OFF-BALANCE SHEET IMPLICATIONS, SPECIAL PURPOSE ENTITIES, AND TRANSPARENCY OF FILINGS BY ISSUERS 45, *available at* http://www.sec.gov/news/studies/soxoffbalancerpt.pdf. *See also* Schwarcz, *supra* note 4, at 49 (discussing this SEC staff report).

To understand how such an examination might proceed, consider a simple example. Counsel are asked to opine on the enforceability of an agreement for the sale of a client's warehouse but learn that the client's sole purpose for selling the warehouse is to use the sale proceeds to pay down debt and reduce balance-sheet leverage. Although this constitutes earnings management, few would argue this transaction is wrongful. Sales of tangible property are commonplace, and relatively few burdens associated with such sales are typically retained by sellers.

Now vary the facts slightly. Assume, first, that counsel are asked to opine on the enforceability of an agreement for the sale of a client's financial assets to an SPV, which in turn sells securities to investors to finance the assets' purchase. So far, this is a classic structured-finance transaction, by itself not wrongful. Next assume that opining counsel learn that the client's sole purpose for engaging in this transaction is, as in the "simple example" above, to use the sale proceeds to pay down debt and reduce balance-sheet leverage. Being earnings management, this revelation raises a warning sign.

Under my Article's framework, counsel should not issue their opinion without favorably resolving this warning sign. Professor Simon likewise would argue that counsel should not issue their opinion without rebutting his presumption that this transaction—a structured-finance transaction used for earnings management—is wrongful.[66] To the extent the finding needed to rebut Simon's presumption is similar to that needed for favorably resolving the warning sign, he and I are effectively saying the same thing.

Professor Simon does not describe precisely how opining counsel should rebut a presumption of wrongfulness. I would expect, however, that a finding that the earnings management is not misleading, and thus not harmful, would be sufficient. That finding certainly should be sufficient, in my judgment, to favorably resolve a warning sign.

In the transaction described above, for example, opining counsel may engage in this finding by examining whether the benefits and burdens associated with the transferred financial assets have been shifted to the SPV and its investors in a manner consistent with a sale of such assets.[67] Counsel also presumably should take into account whether any burdens not so shifted—especially to the extent they constitute contingent liabilities—have been adequately disclosed to the client's investors. To the extent opining counsel find that these benefits and burdens have been shifted in a manner consistent with a sale of financial assets and that any burdens not shifted

66. Simon, *supra* note 50, at 88–91.

67. Indeed, this is much the same analysis that counsel must make in order to opine that the transfer constitutes a true sale for bankruptcy purposes. SCHWARCZ, *supra* note 37, §§ 4:1–4:3.

have been adequately disclosed, that finding ought to be sufficient to resolve concerns under both Simon's framework and mine.[68]

IV. Conclusions

Professors Coffee, Macey, Simon, and I appear to be in fundamental accord that lawyers should ascertain that structured-finance transactions—and, by extension, any other business transactions—on which they opine have a valid business purpose. We also appear to be in accord that opining counsel should remain alert to other possible warning signs of problems, and that where warning signs are spotted opining counsel should investigate further before issuing their opinions.

Professors Coffee, Simon, and I disagree, however, about the extent to which lawyers should be permitted to issue opinions that facilitate the subset of transactions that are structured for the sole or primary purpose of earnings management. Coffee suggests, for example, that a true sale opinion may be misleading to the extent an accountant relies on it to permit the originator to remove liabilities associated with transferred assets from its balance sheet. Simon contends that the issuance of legal opinions to facilitate earnings-management transactions may be incompatible with "the idea of lawyering as a dignified calling"[69] because such transactions are "at best wasteful and at worst misleading."[70]

These are noble aspirations; and indeed, where the earnings-management transaction in question would be illegal under positive law or violative of norms, my Article specifically argues that counsel should not facilitate the transaction by issuing legal opinions. Coffee, Simon, and I may differ, though, in the scenario where the earnings-management (or, by extension, any other business) transaction would be legal under positive law and not violative of norms. Here, I cannot agree that lawyers should be hamstrung by being forced to decide, at the risk of liability, whether they must disregard their clients' requests for legal opinions. The focus in these cases, I argue, should be on whether government itself should restrict the underlying harm.[71]

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68. This is a normative analysis. I make no claim whether, in fact, it will satisfy the SEC staff. *Cf. supra* note 65 and accompanying text (discussing recent SEC staff report on off-balance-sheet transactions). Normatively, though, it should satisfy the SEC staff.

69. Simon, *supra* note 50, at 83.

70. *Id.* at 92.

71. As indeed, I argue, government is beginning to do in the earnings-management context. *See supra* note 65 and accompanying text (discussing the possible impact of the June 15, 2005 SEC staff report on off-balance-sheet transactions).