Acquisition of Shares in a Foreign Country

Michael Gruson
and
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Graham & Trotman
and
International Bar Association

International Bar Association Series

Acquisition of Shares in a Foreign Country
Substantive Law and Legal Opinions

Report of
the Subcommittee on Legal Opinions
of the Committee on Banking Law of the Section on Business Law
of the International Bar Association

and

the Committee on Business Organisations
of the Section on Business Law
of the International Bar Association

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Sterling House
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Wolters Kluwer Academic Publishers
101 Philip Drive
Assinippi Park
Norwell, MA 02061
USA

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2 Harewood Place
Hanover Square
London W1R 1DE
UK

First published in 1993

British Library Cataloguing in Publication Data is available

ISBN 1-85333-755-2

Library of Congress Cataloging-in-Publication Data is available

Typeset by BookEns Limited, Baldock, Herts.
Printed and bound by Hartnolls Ltd, Bodmin, Cornwall.

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— To promote an exchange of information between legal associations world-wide;
— To support the independence of the judiciary and the right of lawyers to practise their profession without interference;
— To keep abreast of developments in the law, and to help in improving and making new laws.

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Introduction

1. The Role of Legal Opinions

In most important international business transactions, particularly where one of the parties has retained U.S. lawyers – but increasingly also where no U.S. lawyer is involved – opinions of counsel are required as a condition precedent to the consummation or "closing" of the transaction. Legal opinions of the kind discussed here state conclusions of law but do not set forth the reasoning underlying such conclusions.

Parties to a business transaction usually ask for legal opinions in order to evaluate the legal risks that may be involved in the transaction. The recipient of a legal opinion rendered in the context of a business transaction wishes to obtain counsel's professional judgment that the legal assumptions upon which the recipient is basing his decision on whether or not to go forward with the transaction are correct. An unqualified favorable opinion is a statement to the recipient that counsel has examined specified legal aspects of the transaction and found them in order. To the extent that counsel is unable to give an unqualified favorable opinion, the recipient is put on notice that the transaction involves certain legal risks which the recipient should evaluate. Generally, one can say, a legal opinion serves to confirm that the legal relationships the parties mean to establish are in fact established.

Thus, in the case of each transaction, the parties and their counsel must determine the relevant legal issues which should be covered by opinions. The negotiations about the scope and language of opinions during the course of negotiating a transaction may uncover legal problems and uncertainties in connection with the proposed transaction. In some cases the parties will change the legal structure of

[1] This introduction is partly based on and follows the Report of the Subcommittee on Legal Opinions of the Committee on Banking Law of the Section on Business Law of the International Bar Association, *Legal Opinions in International Transactions – Foreign Lawyers' Response to US Opinion Requests* (Gruson, Hutter, Kutschera, Reporters; Graham & Trotman and International Bar Association, 2d. ed. 1989), at 4–10 [herein referred to as "IBA International Opinion Report"]. *See* the discussion of the IBA International Opinion Report in Gruson & Hutter, *International Bar Association Project on Legal Opinions in International Business Transactions*, 10 U. Pa. J. Int'l Bus. L. 71–87 (1988). The authors would like to thank Ms. Regine Singh for her assistance in the production of this Report.

the transaction in order to avoid such problems or uncertainties. In other cases the parties must decide whether to accept these problems and uncertainties as a business matter or to abandon the transaction.

The practice of asking counsel – one's own counsel or the counsel to the other party or both – for legal opinions originated in the United States. It is not a common practice in purely domestic transactions in other countries.[2] This difference in practice can be explained by differences of custom and tradition and, in addition, by the fact that civil law countries have developed legal doctrines and methods that make it easier to verify matters such as due incorporation, the power to bind the corporation, etc., than it is in common law countries, such as the United States.

Legal opinions, however, are gaining increasing acceptance in international transactions including transactions involving only non-U.S. parties.[3] The reason is that businessmen and their lawyers when doing business in a foreign country are not familiar with the legal problems they face and frequently conclude that it is prudent to obtain a written evaluation of the transaction and written assurances as to the absence of legal problems. Businessmen often prefer assurances in the form of a written opinion rather than in the form of oral advice because it is a common experience that a lawyer (like anybody else) tends to be more careful if he puts his advice in writing. Carefully thought out exceptions and qualifications to the legal opinion indicate clearly to the recipient of the opinion certain problem areas and issues as to which no legal assurances can be obtained. Properly drafted opinions also determine which issues involved in a transaction are governed by the foreign law and which issues are governed by the law of the home country of the businessman. Such opinions thereby allocate responsibility among the various lawyers.

In difficult transactions lawyers frequently prefer to render written legal opinions because opinions create a record as to the scope of the advice given as well as the exceptions and qualifications noted, and thereby limit the lawyer's liability.

2. Interrelation of the Laws of Several Countries

Frequently a party to a transaction primarily relies on the advice or the opinion of a lawyer admitted to practice in such party's own country ("Principal Counsel") even though the transaction takes place in an international setting and the laws of a foreign country – foreign, insofar as such party is concerned – apply to all or part of such transaction. Principal Counsel is required to determine under the conflict-of-laws rules of his country which issues are governed by foreign law and, therefore, should be addressed in an opinion rendered by a lawyer admitted to practice in the foreign country ("Foreign Counsel") and which issues are governed by

[2] *See* Grabar & Pergam, *International Opinions*, in Sterba, Jr. (ed.), Drafting Legal Opinion Letters (2d ed. 1992), 107 at 109.

[3] Grabar & Pergam, *supra* note 2, at 110 ("In public offerings of securities in Europe, for example, or in large project finance arrangements, opinion letters are delivered to third parties when Americans are nowhere to be found. More generally, the very fact that a transaction is international, and thus that parties are unfamiliar with one another's legal environments, is increasingly a reason to require an opinion.").

his own law and should be addressed by his own opinion.[4] In that sense the opinions assign responsibility for certain legal issues to Principal Counsel and for other legal issues to Foreign Counsel.[5] If only foreign law applies to a transaction (for instance, the purchase of all or a portion of the shares of a company located in a foreign country), a party to that transaction may wish to deal directly with Foreign Counsel.

A party to an international transaction is concerned about all legal aspects relating to the transaction, including issues governed by the foreign law. As far as foreign law issues are concerned, the most important element of Principal Counsel's obligation of diligence (whether Principal Counsel is counsel to the opinion recipient or not) is to obtain opinions of counsel with respect to relevant issues governed by the foreign law. It cannot be emphasized strongly enough that Principal Counsel does not discharge his duties to his client by simply obtaining some opinion from Foreign Counsel. Principal Counsel must make a diligent effort to uncover legal problems that might exist under the relevant foreign law and must ascertain that these problems have been addressed and resolved. Principal Counsel must ascertain that Foreign Counsel is familiar with the transaction and with the purpose and meaning of the proposed opinions. This requires close interaction between Principal Counsel and Foreign Counsel.[6]

3. Third Party Opinions

Traditionally, a U.S. party to an agreement requires a legal opinion from counsel to the *other* party to the agreement. This is the so-called "third-party opinion".

Although neither the IBA International Opinion Report referred to below nor this Report is limited to third-party opinions but both equally apply to opinions requested from and rendered by the opinion recipient's own Foreign Counsel, a brief discussion of the rationale for third-party opinions appears to be appropriate.

The third-party opinion usually covers the same issues as the representations relating to legal matters made in the agreement by the opining counsel's client. The rationale for requiring an opinion from the other party's counsel is that such counsel is usually more familiar with the issues covered by the opinion and that his opinion reinforces his client's representations. For example, if a seller is

[4] Principal Counsel depends on Foreign Counsel's expertise to determine which issues of foreign law are relevant to the transaction by virtue of the conflict-of-laws rules of the foreign law (rather than by virtue of the conflict-of-laws rules of the law of the country of Principal Counsel) and should be addressed in Foreign Counsel's opinion.

[5] The relationship between the opinion of Principal Counsel and the opinion of Foreign Counsel can be stated in the opinions in several ways. In many cases, Principal Counsel will carve out from his opinion the issues of foreign law, and the opinion recipient is advised to look only to the opinion of Foreign Counsel with respect to such foreign law issues. This carve-out can be done by specific assumptions in Principal Counsel's opinion with respect to those legal conclusions under the foreign law which are conditions for the correctness of a legal conclusion reached by Principal Counsel under his law. In other cases, Principal Counsel may give an opinion on a legal issue, expressly stating that his opinion does not cover issues governed by foreign law even though legal conclusions as to such foreign law issues are a condition for the correctness of his opinion under his law, and rely with respect to such foreign law issues on the opinion of Foreign Counsel. *See* IBA Opinion Report, *supra* note 1, at 7.

[6] *See* Gruson, *American Lawyers and Legal Opinions of Foreign Counsel*, 1975 Annual Proceedings of The Fordham Corporate Law Institute 296 (1976).

required by the purchaser to represent in the stock purchase agreement that the agreement has been duly authorized by the seller, the purchaser will require an opinion by the seller's counsel to the same effect. The purchaser's counsel could give this opinion only after a time-consuming and expensive investigation.

The reason why businessmen and their lawyers ask for a legal opinion from counsel to the other party to a transaction is that they wish to be assured that the lawyers for all parties to the transaction have spotted the same legal issues, have thought seriously about the issues involved, and have reached the same conclusions about such issues. After all, all parties to a transaction, including their lawyers, share an interest that there remain no unresolved legal issues, or, as it is sometimes said, that "the deal works". It is common knowledge and everyone's experience that one thinks much more carefully and in a more disciplined way about a subject matter if one has to commit one's conclusions to paper.

Frequently, it has been stated that an opinion from the other party is useful because it may make it difficult for such party later to raise a defense against the contract which contradicts a legal opinion delivered at the time the contract was entered into. For instance, it is argued, that the seller cannot assert lack of authorization if his own counsel has given a legal opinion that the agreement has been duly authorized. However, this "estoppel theory" is not convincing. If an agreement violates a law or if a necessary governmental approval has not been obtained, the legal opinion to the contrary does not prevent the company or anyone else from later raising this issue. If the person who signed the agreement was not authorized to do so, such lack of authority is not remedied by a legal opinion. It may, however, be remedied under a theory of apparent authority.

4. The IBA Report on Legal Opinions in International Transactions

In the past, much time and effort was wasted when a lawyer from one country requested an opinion from a lawyer from another country. Frequently there was basic disagreement about the purpose of the opinion and the terminology used in the opinion. To remedy this unsatisfactory situation, in 1986 the Subcommittee on Legal Opinions of Committee E (Banking) of the Section on Business Law of the International Bar Association ("IBA") presented its Report *Legal Opinions in International Transactions – Foreign Lawyers' Response to U.S. Opinion Requests.*[7] This Report is referred to herein as the "IBA International Opinion Report".

The IBA International Opinion Report explains what a U.S. Principal Counsel and his client want to know from a non-U.S. Foreign Counsel and suggests how non-U.S. Foreign Counsel can best respond to such request in an opinion rendered to U.S. Principal Counsel's client under the Foreign Counsel's law. This explanation is made on the basis of a Sample Opinion which covers all issues typically of concern to Principal Counsel's client in a loan transaction. A loan transaction was chosen as the basis for the Sample Opinion because opinions in connection with loan transactions were well known, and such opinions contain most of the basic elements and opinions found in opinions relating to other commercial agreements. The IBA International Opinion Report comments on each item or clause of the Sample Opinion. The first part of each comment sets forth the United States perspective on the portion of the opinion under discussion and

[7] *Supra* note 1.

either paraphrases or quotes from the New York "Tribar Report" on legal opinions, which reflects generally accepted views – at least as far as New York law is concerned – on legal opinions. The second part of each comment summarizes the related viewpoints of lawyers from Argentina, Australia, Austria, Brazil, Canada, Denmark, England, Finland, France, Germany, Italy, Japan, Korea, The Netherlands, Spain, Switzerland and Venezuela. These foreign responses discuss both the validity of the opinion under the particular foreign legal system and whether or not modifications are advisable. These responses also address the extent of investigation necessary to enable a lawyer to render a correct opinion. Finally, where it was necessary to either explain certain concepts of the Tribar Report or comment on an item or clause of the opinion from a conflict-of-laws perspective, the authors of the IBA International Opinion Report added necessary explanations and comments under the heading "Reporters' Annotations".

The first principal purpose of the IBA International Opinion Report was to improve communication between the lawyer requesting an opinion and the lawyer giving the opinion. Both lawyers must have a common understanding as to the meaning of the terminology used in the opinion. Eventually, they must be able to agree on an opinion formulation which (i) gives the opinion recipient sufficient comfort with respect to his legal assumptions and (ii) reflects the particularities of the legal system of the opining Foreign Counsel.

The second principal purpose of the IBA International Opinion Report was to analyze the interdependence of the opinion of Foreign Counsel and the opinion of Principal Counsel rendered in connection with the same transaction. Where the laws of several countries apply to a transaction, the opinions of Principal Counsel and of one or more Foreign Counsel must be put together like the pieces of a puzzle before the recipient can be certain that all relevant legal issues under all relevant legal systems have been fully addressed by the opinions in a seamless manner.

5. History of this Report

The IBA International Opinion Report suggested that the next project of the Opinion Subcommittee of Committee E (Banking) might be the study of legal opinions rendered in connection with transactions involving acquisitions and the sale of securities.[8] At the 9th Conference of the IBA's Section on Business Law (Strasbourg, 1989), the Opinion Subcommittee decided to embark on that project and to study legal opinions regarding the issuance and transfer of shares of capital stock. The Opinion Subcommitee was of the view that it should cooperate in its study with the Committee on Business Organizations (Committee G) in order to make the expertise of its members available for the project.

At the 23rd Biennial Conference of the IBA (New York, 1990), a joint meeting between the Opinion Subcommittee and Committee G (under its Chairman Willem T.L. Calkoen; Nauta Dutilh, Netherlands) discussed legal opinions relating to the issuance and transfer of shares in cross-border acquisition transactions in a panel discussion with Peter Verloop (Nauta Dutilh, Netherlands), José Martins Pinheiro (Pinheiro Neto Advogados, Brazil), Olivier d' Ormesson (Gide Loyrette

[8] IBA International Opinion Report, *supra* note 1, at 12.

Nouel, France), Hans-Michael Giesen (Bruckhaus, Westrick, Stegemann, Germany), Richard Cooper (Slaughter & May, England), Stephan Hutter (Shearman & Sterling, United States), Michael Gruson (Shearman & Sterling, United States), Fernando Pombo (Gomez, Acebo & Pombo, Spain) and Ronald J. White (Norton Smith & Co, Australia). The Opinion Subcommittee presented at the New York Conference a first exposure draft of this Report. At the 10th Conference of the IBA's Section on Business Law (Hong Kong, 1991), the joint meeting of the Opinion Subcommittee and Committee G continued its discussion in a panel with Peter Verloop, Thierry Brocas (Gide Loyrette Nouel, France), Richard Cooper, Michael Gruson, Stephan Hutter, Michael Kutschera (Binder Grösswang & Partners, Austria), José Martins Pinheiro, Fernando Pombo and Ronald J. White. At the Hong Kong Conference, a comprehensive revised exposure draft for this Report was presented. Finally, the publication of this Report was announced at the 24th Biennial Conference of the IBA (Cannes, 1992).

6. The Purpose of this Report

The Opinion Subcommittee realized that in connection with negotiated acquisitions of companies in another country legal opinions are frequently requested by the foreign purchaser. In addition, the number of cross-border acquisitions of companies has increased greatly in the recent past and can be expected to continue to grow in the future. The transaction may take the form of a sale of issued and outstanding shares by a present shareholder to the purchaser or of the issuance of new shares by the target corporation to the purchaser. The prudent purchaser requests legal assurances that the shares were duly authorized and validly issued, that he in fact acquired the shares he bargained for, that the shares acquired in fact represent the desired percentage of the target company, and that the acquired shares are free of liens and assessments. If the purchaser knew that the legal conclusions set forth in the opinion were incorrect, he might not go through with the transaction.

Under applicable conflict-of-laws rules, these issues are probably governed by the law of the country of incorporation of the target company. Since the relevant law in various countries is quite technical, a purchaser from another country cannot rely on his general business experience to avoid misjudgment and pitfalls. It also appears imprudent to many businessmen who acquire a company in a foreign country merely to rely on a nod of his own Foreign Counsel indicating "Don't worry, everything is OK". Too much is at stake, and the legal rules in this area are too complicated for a purchaser to be satisfied with such spoken or "whispered" assurance.

The problem arises when the businessman who negotiates the acquisition of a block of shares or all of the shares of a foreign company asks his own counsel (he may be a member of the purchaser's own legal department or a practicing lawyer in the purchaser's country) to discuss a proper opinion text with a lawyer of the country in which the target company is located (he may be a member of the legal department of the target company). The lawyer of the purchaser most likely will prepare an opinion that is based on the law of his own country and uses concepts and terms known to him. These concepts and terms may make little or no sense under the laws of the country where the target company is located. Furthermore,

even the lawyer of the country in which the target company is located may not have considered in detail the legal issues involved in an opinion relating to the issuance and sale of shares. Frequently, lengthy discussions ensue about the proper legal opinion.

The Opinion Subcommittee wishes to improve and simplify the communication between the lawyer requesting the opinion and the lawyer giving the opinion by proposing model opinion language on the laws relating to the issuance and purchase of shares in 27 jurisdictions. In the end, both counsel must be able to agree on an opinion formulation which (i) gives the opinion recipient sufficient comfort with respect to his legal assumptions and (ii) reflects the particularities of the legal system of the lawyer giving the opinion. As discussed under 3 above, this Report does not take a position about whether the purchaser of shares in a foreign country should request an opinion from a Foreign Counsel who is the lawyer to the seller or issuer (the so-called third-party opinion) or from Foreign Counsel who is retained by the purchaser. The discussions in this Report apply equally to both cases.

Different from the approach taken in the IBA International Opinion Report, the Opinion Subcommittee is of the view that in the area of the law under discussion, it is not sufficient to propose certain opinion formulations and to briefly explain their purpose and meaning. Principal Counsel requesting the opinion from Foreign Counsel should have a basic understanding of the rules of the corporate law relating to the issuance of shares and the rules of the law relating to the sale of shares in order to be able to understand the requested opinion against the background of that law. Only if Principal Counsel has a basic knowledge of the corporate law relating to the issuance of shares and of the law relating to the sale and transfer of shares will he be in a position to discuss the opinion rationally with the opining Foreign Counsel and evaluate modifications, exceptions and qualifications proposed by the opining Foreign Counsel. Thus, each chapter of this Report will give a concise summary of the applicable law and then propose an appropriate model opinion. The discussion of law in the various chapters of this Report is primarily intended to be of use to the Principal Counsel requesting an opinion. It is assumed that the opining lawyer knows more about the areas of law discussed than the brief summaries in this Report can give. For that reason, this Report generally does not cite legal authorities to support the statements made. The lawyer requesting an opinion does not need such citation, and the lawyer giving the opinion is familiar with and can easily refer to the legal literature of his own country.

This Report addresses the acquisition of all or part of the shares of a company in a negotiated transaction (share deal). This Report does not cover the acquisition of assets of a company (asset deal) and, for most countries, the purchase of shares from the public, be it through a stock exchange or by way of a tender offer. The authors of the various chapters of this Report are responsible for the correctness of their chapters.

New York/Frankfurt
December 1992

Michael Gruson
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