IP Opinions to Underwriters in U.S. Public Offerings

BY EDWIN L. MILLER JR. OF SULLIVAN & WORCESTER LLP

Edwin L. Miller Jr. is a partner at Sullivan & Worcester LLP in Boston. He is a graduate of Harvard Law School and the author of two books, both published by Wiley: "Lifecycle of a Technology Company: Step-by-Step Legal Background and Practical Guide from Startup to Sale" *and* "Mergers and Acquisitions: A Step-by-Step Legal and Practical Guide." *He may be reached at emiller@sandw.com. The views expressed in this article are his own and not necessarily those of other lawyers in his firm.*

In public securities offerings in the United States, counsel for the underwriters of the offering typically require that the company furnish a legal opinion to the underwriters from its outside intellectual property/patent counsel. Our experience has been that IP counsel frequently give opinions that are not necessary and create unintended liability. It is also likely that this practice violates the golden rule in these matters – don't ask for an opinion from another firm that your firm would not give.

The purpose of legal opinions in public offerings is to assist the underwriters in establishing a "due diligence defense." Under the Federal securities laws, underwriters share liability with the company for the offering prospectus, but avoid liability if they establish a so-called "due diligence defense." One component of that defense is to obtain various legal opinions from the company's corporate counsel, as well as its IP and regulatory counsel, where applicable.

Securities lawyers for the company virtually always are requested to give a legal opinion, and these opinions are routinely given. The issue here is not whether it is imprudent or "off-market" for law firms to render corporate or IP opinions to underwriters; rather, the issue is the appropriate scope of these opinions.

Opinions requested of IP firms fall into several general categories:

- Specific factual statements in the offering prospectus are accurate.
- Knowledge-limited opinions relating to patent validity, non-infringement and similar matters.
- An opinion that the "IP portions" of the prospectus (often unspecified) are complete and accurate or fairly present the appropriate information.
- An opinion that the prospectus does not contain any misleading statements related to IP matters and doesn't omit any material information concerning IP.

The first two requests are fairly conventional and are not problematic, at least as properly limited or qualified. For example, the knowledge-limited opinion on non-infringement should not be phrased in such a way that it amounts in effect to a "freedom to operate" opinion.

The last two requests are problematic.

The "IP portions" are generally considered to be the section concerning the "risk factors" of the offering and the description of the company's IP. The risk factors section consists of extensive boilerplate generically stating IP risks like the risk of infringement, the high cost of IP litigation, possible insufficiency of the company's patent protection and the like. With respect to the portion that describes the company's IP portfolio, the request may cover such matters as whether the information given fairly summarizes the scope of the company's patents.

The last two requests effectively ask the IP lawyer to give a securities laws opinion. This is a sensitive subject since securities lawyers don't give a formal opinion to this effect; rather, it is accepted practice that a "negative assurance" statement be given separately from the opinion. The negative assurance statement is highly stylized with multiple accepted qualifications. Among them are that the statement is based on the law firm having participated in multiple drafting sessions with the other offering participants, that counsel has not independently verified the information in the prospectus and does not assume responsibility for its content. After those qualifications comes a statement that "nothing has come to counsel's attention" that leads them to believe that there has been a material mis-statement or omission.

These requests of IP counsel are seemingly innocuous, but in reality are far from it. Effectively, IP counsel are being asked to give opinions that are beyond their expertise and not in accordance with the best industry practice. It is not necessary for the underwriters to establish a due diligence defense that IP lawyers effectively opine on the adequacy of standard IP risk factors. Corporate counsel routinely give the underwriters the "negative assurance statement" to the effect that the prospectus as a whole is not misleading. There are three predicates to giving this statement:

- The first is that securities firms resist giving negative assurance statements on particular sections of the prospectus and only give them on the prospectus as a whole. That's important since the materiality standard is more difficult to run afoul of for the document as a whole as opposed to a particular section. In other words, a particular section may have a statement that's misleading, but that misleading statement doesn't make the prospectus as a whole misleading.
- The second is that these firms are experts in U.S. securities laws.
- The third is that such statements are given by securities lawyers only where the securities lawyer has participated fully in the extensive due diligence and drafting sessions for the public offering.

None of these predicates are applicable to IP lawyers giving opinions to underwriters.

Despite these issues and the potential liability they create, the majority of IP lawyers give these opinions exactly as asked, not understanding that there is room for negotiation. Naturally, when objections are raised, aggressive underwriters and their counsel will insist that the requested opinion is perfectly appropriate and customary and make that point to the IP counsel's client as well. The conundrum is that IP firms feel that they have no choice because other firms give such opinions. The reality is that IP firms that are sophisticated in these matters aggressively negotiate to limit the scope of what they give to what is appropriate. Further, a number of prominent IP firms simply refuse to give any opinions to underwriters under any circumstances.

Further, in relatively rare instances, IP counsel will be asked to "expertise" the intellectual property sections of the prospectus or specific portions. The firm is then named as an "expert" in a special section of the prospectus. Law firms strongly resist this request as it creates direct liability to the investors who are buying multiple millions of dollars of the offered securities. In some circumstances, particularly with respect to IP disputes, it is essential for marketing reasons for these matters to be expertised. Law firms do so on occasion and with great reluctance, but should do so understanding the risk implications and only if they are properly compensated for the risk.

We are not suggesting that IP lawyers not assist the underwriters in establishing their due diligence defense by rendering an appropriate opinion letter. The opinion letter should be limited in scope to matters relating to the company's intellectual property estate and not an indirect securities law opinion. IPT