



FAIRNESS OPINION ALERT I

The *Wall Street Journal* recently reported that the NASD, the main self-regulatory body for brokerage firms, has begun an inquiry into possible conflicts of interest by investment bankers who provide both M&A advisory services and fairness opinions for the same transactions.

Transactional fairness opinions became common following the 1985 landmark case *Smith vs. Van Gorkom*. In that case, the Delaware Supreme Court ruled that the Trans Union Corp. Board of Directors neglected its fiduciary duty and sold the company without sufficient preparation or investigation and sold the company for too little money. The members of the Board of Directors were held personally liable in this case.

In many corporate M&A transactions, it is typical for the Board of Directors to seek a fairness opinion from the investment bank involved in sourcing, structuring, and negotiating the proposed transaction. The investment banker generally stands to receive a considerable fee that is contingent upon the successful completion of the transaction.

A recent *New York Post* article, “*Eliot’s Fair Play*,” noted that New York Attorney General Eliot Spitzer might be looking into the “fairness” of certain fairness opinions. The article referenced a speech given by Spitzer in which he indicated that he was concerned about advisors providing fairness opinions on the actual deals they negotiated, and for which they earned large success fees, and almost never concluding that the deals were unfair. Spitzer’s spokesperson confirmed to *The Post* that Spitzer thought this issue should be reviewed.

Additionally, a recent Delaware court case, *Pure Resources, Inc. Shareholders Litigation*, suggests that controlling shareholders as well as their boards and special committees will be held to more stringent disclosure requirements for fairness opinions. The influential Delaware court held that, as a matter of state corporate law, a corporation must provide its shareholders with full disclosure of the financial analyses underlying any “fairness opinion” received by the target’s board of directors or special committee in connection with an acquisition by a controlling shareholder, even in tender offer transactions where this disclosure is not required by the federal securities law.

Based on its investigation and findings, the NASD board of governors could propose new rules governing prospective fairness opinions, such as making investment bankers

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responsible for independently verifying the value of a transaction before issuing a fairness opinion to the board and stating that the deal is fair to its shareholders.

In addition, the NASD could propose disclosure requirements, similar to the current Securities and Exchange Commission (SEC) reporting requirements within public financial filings involving executive compensation. These requirements could include: (1) any other fees that investment bankers who provide the fairness opinion will receive as compensation, and (2) information about any management compensation or rewards tied to the completion of a deal, such as bonuses, stock vesting, and other perks that grow out of deal consummation. Eventually, regulators may require reforms that go beyond disclosure, mandating that fairness opinions be issued by financial advisors that do not have an advisory role, receiving a success fee, in the transaction.

With the enactment of Sarbanes-Oxley, we believe that certain areas to be particularly aware of, regarding fairness opinions, are any apparent and real conflicts of interest and independence in an M&A transaction. Today, appearances are almost as important as substance. Directors cannot simply approve a transaction because management supports the deal and the financial advisor indicates that it is fair. The board must conclude, “We studied this deal, we discussed it, and we think it’s fair,” and it must be able to explain how it arrived at its conclusion.

The ground rules governing M&A activity have changed drastically and companies that aren’t aware of the new environment are inviting trouble, intensified SEC and other regulatory body scrutiny. Negative results could include delayed or even aborted transactions, and lawsuits accusing directors of violating their fiduciary duties to shareholders. We recommend that a fairness opinion from an experienced financial advisor who does not have an advisory role in the transaction, or independent directors and boards obtain a second fairness opinion from an experienced and independent financial advisor.

This is the first in a six-part series of updates on the “state-of-the-market” and some guidelines relating to the use of this important tool for fiduciaries.

BCC Capital Partners is a premier, independent provider of valuation and fairness opinions. With over 17 years of service to its clients and their advisors, BCC has completed an extensive number of valuations, fairness opinions, solvency and insolvency opinions. BCC Capital Partners is also a State Bar of California approved provider of MCLE courses, and offers an MCLE course on fairness opinions. Inquiries to discuss specific valuation, transaction advisory matters or MCLE courses are welcomed.

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