# Fighting over Fairness Opinions

*Corporate Control Alert*
By David Marcus
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For a genre of short letters carefully crafted to say as little as possible, fairness opinions have generated a great deal of controversy in recent months. In November, the NASD issued to its members a request for comment on rules governing the letters investment banks write for boards of directors offering an opinion as to whether a transaction is fair from a financial standpoint.

By the end of the comment period on Feb. 1, the NASD had received responses from 18 parties ranging from public and union pension funds such as the California Public Employees' Retirement System and the AFL-CIO to the Securities Industry Association.

The comments focused on two issues: the amount of information a company should disclose along with the opinion; and whether an investment bank should provide a fairness opinion on a deal whose completion will reward it with a success fee. Most commentators say they could accept requirements for greater disclosure of financial analysis and potential conflicts, but views on the second issue were split, with public pension funds favoring it and those on Wall Street opposing it. The NASD has no timetable for considering the responses or proposing additional rules governing fairness opinions, a spokesman says.

Shaping the debate are commentators' perspectives on the purpose and utility of fairness opinions. In their letters to the SEC, lawyers and the SIA note that fairness opinions are rendered for the benefit of the board as part of the provision of investment banking advice. Some activist shareholders argue that they should be able to use the letters like analyst reports, since a fairness opinion lends an investment bank's imprimatur to a transaction. And many academics, including governance guru Charles Elson, question the value of fairness opinions altogether.

That latter difference of opinion is interesting because it represents a split within the corporate governance community generally.

The debate on fairness opinions has been brewing since at least 1985, when the Delaware Supreme Court issued a ruling that made more boards request them. In Smith v. Van Gorkum, the court held that the target board violated its duty of care by approving a sale even though the offer came at a 50% premium to its trading price. The court found that the board acted with gross negligence and imposed personal liabilities on directors. In response, other boards sought fairness opinions to show that they had thoroughly considered a deal and thus met their fiduciary duties even though the Van Gorkum opinion specifically says Delaware law does not require a board considering a deal to get a fairness opinion.

"The origin comes out of Van Gorkum, so you have to ask what value comes out of these opinions other than to provide evidence of good faith of the board," says Elson, the director of the John L. Weinberg Center for Corporate Governance at the University of Delaware. Though banks often provide fairness opinions as part of their investment banking advice, they charge fees for them that can run to several million dollars on large deals. "It's protected the board and it costs the investors a good bit of money," Elson says, noting that he still thinks investment banks can play a significant role in valuing and negotiating deals.

Such skepticism is not new. In a 1989 paper, Marcel Kahan, now a professor of corporate law at the New York University School of Law, and Lucian Bebchuk of Harvard Law School suggested that judges "exercise substantial caution in assessing and giving weight to fairness opinions." Kahan recently said that he thought most investors have also long understood the basic conflict underlying fairness opinions.

Apparently not. The AFL-CIO's corporate transactions coordinator, Michael Garland, analogizes fairness opinions to analyst reports that investment banks issue on publicly traded companies. While companies should disclose any conflicts a potential deal poses and the NASD should establish standards for the provision of fairness opinions, such reforms are not enough, he says. The AFL-CIO favors barring arrangements where a bank receives a fee contingent on a deal's closing for rendering a fairness opinion. Instead, the union, whose pension funds hold more than $400 billion in assets, would prefer a company get a fairness opinion from a bank that charges only for that service.

"Institutional investors in the past several years have been burned by conflicts of interests that are systemic in the capital markets," Garland says. "This is very much like the conflicts the Sarbanes-Oxley Act attempts to address, and that Eliot Spitzer has tried to address in the insurance industry."

From this perspective, the fight over fairness opinions is part of the larger struggle between corporate America and large pension funds that have become increasingly critical of governance methods. Here as elsewhere, the pension funds argue that shareholders should play as active a role as possible in corporate governance. Those who advise corporate boards reply that their clients are more informed about their companies than shareholders and should be accorded some deference because of that knowledge.

"These opinions really aren't for shareholders," said Erica Steinberger, of counsel at Latham & Watkins LLP in New York and the signer of a comment letter on the issue from the Association of the Bar of the City of New York's special committee on mergers and acquisitions. "It's the board that has all of the information, that looks at the analysis, that studies it, and thinks about whether the assumptions are reasonable or not."

The absence of negative fairness opinions reflects the realities of the negotiating process, she

adds. "You never ask somebody for something they can't give," Steinberger says. "It's a bad idea. It creates a bad record." If a company is negotiating a deal, "You don't say, ‘Is this fair?' You look at [the bankers] and say, ‘Do you think you can get there?" If they say no, you don't do the deal."

The AFL-CIO cites the proposed merger between Mony Group Inc. and Axa Financial Group Inc., announced Sept. 17, 2003. Mony received a fairness opinion from Credit Suisse First Boston even though Axa's offer came at only a 6% premium to Mony's Sept. 16 closing price. Noting that CSFB stood to receive a $15 million success fee if the deal closed, the AFL-CIO cites the deal as evidence that an adviser conflicted in such a way shouldn't be allowed to render a fairness opinion.

But as the AFL-CIO notes, shareholders vehemently opposed the deal, and only 53% of them ultimately approved it. Evidently, a substantial number of Mony shareholders disregarded CSFB's verdict on the deal. "The market ultimately decides the appropriateness of the transactions, not the fairness opinion," says Elson, who favors getting rid of such letters altogether.

Kahan also believes that shareholders are smart enough to ignore fairness opinions when appropriate. "On all the questionable deals, I don't think that there were many shareholders who said, ‘Oh, look there, a fairness opinion, let's vote yes,'" he says.

He doubts that requiring companies such as Mony to get a fairness opinion from a second investment bank would be useful. "Getting an independent banker just adds cost to the system," he says. "You're going to call up someone whom you know is going to give the opinion you want."

He adds: "The solution is not going to remove the problem, and maybe it's just better not to complicate the system but live on in the awareness of what the problem is and the awareness that fairness opinions are tainted and always will be in some respects instead of trying at high cost to perfect a system that can't be perfected."