

Alert

June 2003

Is Your Fairness Opinion Really Fair?

"Boards of directors or others seeking a fairness opinion need to ensure that the provider of the opinion is independent in order to avoid any perceived conflict."

In this time of increased corporate governance, boards of directors, trustees or other seeking a fairness opinion need to ensure that the provider of the opinion is independent in order to avoid any perceived conflict. In many instances, the financial advisor who initiated the transaction may not be well suited to provide such a fairness opinion due to its material relationship with the company.

A recent New York Post article, "*Eliot's Fair Play*," notes that New York Attorney General Eliot Spitzer may be looking into the "fairness" of certain fairness opinions. The article references a speech given by Spitzer in which he indicated that he is concerned about advisors providing fairness opinions on the actual deals they negotiated and almost never concluding that the deals are unfair. Spitzer's spokesperson confirmed to The Post that Spitzer thinks this issue should be reviewed.

Additionally, a recent Delaware court case suggests that controlling shareholders as well as their boards and special committees will be held to more stringent disclosure requirements for fairness opinions. This issue of the *Alert* focuses on the types of situations where a fairness opinion is needed, and concludes with a summary of the Delaware court case and the implications of the case.

WHY A FAIRNESS OPINION IS NEEDED

A fairness opinion is obtained by a company's board of directors to provide them with assurance that the price or terms of a transaction are fair and reasonable to shareholders. Also, a fairness opinion protects the board of directors from potential legal matters which may arise if the transaction is not as successful as originally planned. Corporate activities that typically require a fairness opinion include acquisitions or divestitures, leveraged or management buyouts, restructurings, related party transactions, indenture requirements, and ESOPs.

PREPARING A FAIRNESS OPINION

In preparing a fairness opinion, the financial advisor's role focuses on three main issues: 1) the value of the consideration received or paid, 2) the terms and structure of the transaction, and 3) the shareholder value under a potentially different scenario than the one under review.

Conducting a fairness opinion requires interviewing the company's management and legal advisors, reviewing all legal documents, analyzing historical statements, and assessing business plans and financial projections.

Valuation Research Corporation has provided independent fairness opinions for a wide range of transactions. The following case studies show the types of situations requiring fairness opinions.

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VRC NEWS

VRC will be presenting a webcast, "Fairness Opinions in a Changing Environment," on August 7, 2003. Register at www.valuationresearch.com/registration.htm.

Robert Cronin will present "The Role of Valuation Experts in Financial Statement Presentation," as part of the CITE (Council for International Tax Education) 6th annual conference on Managing The Global Effective Tax Rate. The Conference will be held July 28 & 29 in Chicago. Register at <http://www.fdtacite.org/>.

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Related Party Transaction - A publicly held communications company needed additional capital to avoid defaulting on loan covenants. A significant shareholder was willing to invest additional financing or "backstop financing." A special committee of the board of directors was formed by outside board members to oversee the shareholder's issuance of a multimillion dollar, senior secured credit facility. The Committee hired several advisors to negotiate the terms. We reviewed the terms of the financing and presented our conclusions to the board of directors and trustees. Our analysis involved tracking the negotiation process, comparing facility terms, and performing an independent facility rating and yield analysis.

Recapitalization - A multibillion dollar, privately held company required additional financing to improve its financial structure which was overly leveraged. Outside investors were negotiating to invest \$500 million in the Company. We were asked to provide a fairness opinion regarding the terms and conditions of the letter of intent. Our analysis included reviewing the terms of the letter of intent with terms and conditions of similar transactions.

VALUATION SUMMARY REQUIRED

A recent Delaware court case, *In re Pure Resources, Inc. Shareholders Litigation*, suggests that controlling stockholders and their boards and committees will be held to more stringent disclosure requirements for fairness opinions. In *Pure Resources*, minority stockholders of Pure Resources, Inc. sought an injunction from the Delaware Chancery Court against Unocal Corporation's unsolicited offer to exchange its common stock owned by the minority stockholders.

While the decision resulted in new guidance for a controlling stockholder's buyout of minority stockholders in a Delaware corporation, the Court also suggested that a summary of the fairness opinion should be part of the disclosure documents. The Court found that the financial advisors who conducted the fairness opinion neglected to provide minority shareholders with a summary of the analysis, information that would have been helpful to minority stockholders in deciding whether or not to tender into Unocal's exchange offer.

Vice Chancellor Leo Strine Jr. of the Delaware Chancery Court said that the value of the fairness opinion is not in the conclusion but "the valuation analysis that buttresses that result." The Court held that stockholders are entitled to a summary which includes the basic valuation exercises, key assumptions used, and the range of values generated.

In light of the Delaware court case, we advise boards of directors to take the following measures: obtain fairness opinions from independent providers and make sure that disclosures to minority stockholders are adequate. For more information on fairness opinions, contact your Valuation Research representative or Bryan Browning at 414/221-6249. **VR**

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