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SEC Approves New FINRA Standards for Fairness Opinions

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Effective December 8, 2007, the Securities and Exchange Commission approved a proposal from the Financial Industry Regulatory Authority (FINRA), the successor body to the National Association of Securities Dealers, to introduce new disclosure and procedural requirements for fairness opinions issued by member firms of FINRA.

Fairness opinions are frequently used in connection with change of control or other material corporate transactions to opine on the fairness, from a financial perspective, of the proceeds of the transaction. In its proposal, FINRA expressed concern that the existing disclosures contained in fairness opinions did not adequately alert shareholders to potential conflicts of interest between the member firm issuing the fairness opinion and other parties to the transaction.

The new Rule, added to the NASD Manual as Rule 2290, applies only to member firms of FINRA. In addition, compliance with the Rule is triggered only if, at the time a fairness opinion is issued to the board of directors of a company, the member firm issuing the fairness opinion knows, or has reason to know, that the fairness opinion will be provided or described to the company's public shareholders (for example, if the transaction is structured to include shareholder approval).

A key aspect of the new Rule is that member firms issuing fairness opinions must have adopted written procedures for the internal approval of an opinion. The internal procedures are required to include the circumstances when an internal fairness committee or other internal group would be used to

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review the opinion and, when a committee was used, procedures for selecting its personnel, the necessary qualifications of such persons, and the processes used to ensure that the opinion is not reviewed exclusively by persons involved in the transaction. Rule 2290 also requires procedures to determine the appropriateness of the valuation analysis used in the opinion.

In addition to the requirement for procedures in connection with the internal approval of a fairness opinion, Rule 2290 also introduced a number of new disclosure requirements that member firms must comply with when issuing fairness opinions subject to the Rule:

- *Contingent Compensation:* If the member firm serves as a financial adviser to any party in the transaction, it must disclose in the fairness opinion if the member will receive compensation that is contingent upon (i) the successful completion of the transaction, (ii) the member rendering the fairness opinion, and/or (iii) serving as a financial adviser. In addition, if the member will receive any other significant payment or compensation, it must disclose such arrangement. The Rule does not require a quantitative disclosure of the compensation, but rather, FINRA stated that a descriptive disclosure of contingent compensation was sufficient to alert shareholders to the arrangement and potential conflict;
- *Material Relationships:* Member firms are required to disclose any material relationships with any party to the transaction that existed during the preceding two-year period or any material relationships that are mutually understood to be contemplated, in which any compensation was received or is intended to be received as a result of the relationship between the member and any party to the transaction;
- *Independent Verification of Information:* Member firms are required to disclose any information that has been independently verified by the member that formed a substantial basis for their fairness opinion, and if so, a description of the information or categories of information that were verified. FINRA noted that the purpose of this disclosure was to provide shareholders with information on the extent to which information relied on by the member firm was independently verified. Where no information was verified, a member firm can make a blanket statement to that effect;

- *Use of Disclosure Committee:* Member firms are required to state whether or not the fairness opinion was approved or issued by an internal fairness committee of the member firm, reflecting FINRA's belief that fairness opinions reviewed by a committee following the new procedures under Rule 2290 would be less susceptible to conflicts; and

- *Relative Compensation of Officers, Directors, and Employees:* Disclosure is also required as to whether or not the fairness opinion expresses an opinion about the fairness of the amount or nature of the compensation to the company's officers, directors, or employees, or class of such persons as a result of the transaction, relative to the compensation to be received by the shareholders of the company.

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