

Fairness Opinions – A Hot Issue Gets Hotter in Recent NYSE Merger

By Craig A. Jacobson*

In the marketplace, crisis can often translate into opportunity. For business appraisers, the current controversy surrounding fairness opinions may open up new prospects for providing this vital and valuable work.

Fairness opinions have recently come under attack in courtrooms and pressrooms—for being marred by conflicts of interest and for sometimes failing to provide meaningful information, even when the issuer is “independent.” The current controversy may be seen as part of the larger universe of corporate difficulties.

“Conflicts between the board and financial experts who issue fairness opinions have become the norm,” observed Judge Charles Ramos, in reviewing the recent negotiated settlement between parties to the merger of the New York Stock Exchange (NYSE) and Archipelago Holdings, Inc., an electronic trading platform. “Fairness opinions have become watered down and toothless.”

As most business analysts know, a fairness opinion is a qualified, independent review by a financial advisor, assessing whether the price of a prospective transaction is “fair” (from a financial perspective) to one of the parties. Either the buyer or the seller may obtain a fairness opinion, although it’s become standard for a Board of Directors to obtain the opinion on behalf of shareholders. A fairness opinion focuses on the price of the proposed transaction without assessing any other terms of the deal, including its legal aspects. It’s a simple yes or no proposition.

“The important purpose of fairness opinions appears to have been lost,” according to Judge Ramos. When he asked the top-flight attorneys and financial advisors assembled for the NYSE merger hearing whether they were aware of any negative fairness opinions, “the response was a resounding ‘NEVER’” (emphasis in the original opinion).

Business valuator’s opinion brings “fair and balanced view”

A unique aspect to the NYSE/Archipelago merger was the challenge by Willamette Management Associates, an independent business valuator, whose analysis of the opinions in the case ensured “transparency and complete disclosure in stark contrast to the usual perfunctory fairness opinion,” the Judge said.

From the beginning, various NYSE seatholders had disputed the fairness of the proposed combination, claiming that they should receive a larger portion of the merged company. Plaintiffs filed a preliminary injunction to delay the merger until all seatholders had the ability to cast a “free and informed vote.”

The parties eventually settled, conditioned on the NYSE obtaining an independent report and analysis of the pros and cons of the merger—its second in the case, which they did, hiring Citigroup Global Markets Inc.

Whether Citigroup’s report satisfied the requirement is “debatable,” the Judge said. “What the parties received was yet another standard fairness opinion.”

The Court based its statement on plaintiffs’ retention of Willamette to review the Citigroup report. Among other deficiencies, Willamette cited: 1) Citigroup’s reliance on financial projections that were similar in nature to the projections used in the original fairness opinion; 2) its failure to value the NYSE as a standalone, for-profit corporation able to pursue new lines of business; and 3) its failure to explain the NYSE’s payment of a 250% premium for Archipelago stock.

The intent of Willamette's report was not to overturn the merger, but to critique the Citigroup report. The Judge determined that the Willamette report satisfied the disclosure goal of the settlement agreement. "The filing of the Citigroup Report together with the critical comments by plaintiffs' experts contained in the Willamette report is unique," the Court said:

...Unlike relying on a typical fairness opinion, these competing presentations provide a fair and balanced view of the proposed merger and present the NYSE Seatholders with an opportunity to exercise their own business judgment with eyes wide open.

New opportunities for business appraisers

The controversy surrounding fairness opinions shows no signs of dissipating. In fact, the National Association of Securities Dealers (NASD), the private-sector regulator of the U.S. securities industry, recently proposed Rule 2290 that would require greater disclosure to shareholders about the company's actual or potential conflicts of interest with the valuation agent rendering a fairness opinion. Rule 2290 would also require valuers to identify any such conflicts of interests.

This heightened oversight may mean more professional opportunities for business appraisers, because fairness opinions utilize common valuation methodologies, and tap into skills and resources appraisers already have. As corporate boards start looking beyond their investment bankers and accounting firms to render these opinions, it's natural that they'll look to the valuation community.

There is already evidence that fiduciaries are seeking unbiased advice and meaningful comments on proposed corporate transactions. Even before a company receives a formal M&A offer, many independent directors are contacting business appraisers and/or fairness opinion providers for advice—and it's an opportunity few in the field will want to miss.

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