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February 1, 2005

VIA EMAIL: pubcom@nasd.com

Barbara Z. Sweeney
NASD
Office of the Corporate Secretary
1735 K Street, N.W.
Washington, D.C. 20006-1500

Re: Notice to Members 04-83 -- Request for Comments on Whether to Propose New Rule That Would Address Conflicts of Interest When Members Provide Fairness Opinions in Corporate Control Transactions

Dear Ms. Sweeney:

The Fairness Opinion Task Force of the Capital Markets Committee of the Securities Industry Association ("SIA")[1] is pleased to submit this response to the above-referenced Notice to Members (the "Notice"). The Notice seeks comments regarding whether the NASD should propose new rules that would (1) require member firms to make specified disclosures when they provide fairness opinions in corporate control transactions, and (2) govern the internal procedures that member firms must follow in rendering fairness opinions.

Financial advisors typically provide fairness opinions in corporate control transactions, including mergers and acquisitions, as well as purchases or dispositions of material assets, divisions or subsidiaries. Fairness opinions are prepared for and delivered to a company's board of directors (or committee of the board of directors, as applicable), and express a view as

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1 Securities Industry Association, established in 1972 through the merger of the Association of Stock Exchange Firms and the Investment Banker's Association, brings together the shared interests of nearly 600 securities firms to accomplish common goals. SIA members (including investment banks, broker-dealers and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs more than 800,000 individuals. Industry personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift and pension plans. In 2003, the industry generated $209 billion in domestic revenue and $278 billion in global revenues. More information about SIA is available on its home page: www.sia.com. A list of the seventeen SIA member firms that participated in the Fairness Opinion Task Force is included on the last page of this letter.

to the fairness, from a financial point of view, to the company or its shareholders, as applicable, of the consideration to be paid or received in the proposed transaction, or of the exchange ratio in the case of stock-for-stock transactions. Fairness opinions are prepared for the use and benefit of boards of directors (or committees thereof) as part of their exercise of due care in evaluating a potential transaction, and customarily indicate that they do not constitute recommendations to shareholders as to how shareholders should vote on a proposed transaction, or whether they should take any other action (such as tendering shares into a tender or exchange offer). Fairness opinions are based upon market, economic and other conditions as they exist on the dates the opinions are delivered, and are further based on the information that has been made available to the opinion provider as of such dates. In this regard, financial advisors analyze the information that is provided to them and other publicly available information that they deem relevant, but they rely on the accuracy and completeness of all such information, and in giving fairness opinions, financial advisors generally do not assume any responsibility for independently verifying such information. The terms relating to the scope and use of fairness opinions and the ability of financial advisors to rely without independent investigation upon the information provided to them are generally embodied in the engagement letters that are entered into by financial advisors and companies and, in our experience, are almost always reiterated in the opinions themselves.

While fairness opinions are of limited scope and purpose, SIA believes that the meaning and purpose of such opinions is well understood within the M&A community, including boards of directors, transaction counsel, both federal and state courts, and the Securities and Exchange Commission (the "SEC"), and that practice with regard to fairness opinions has evolved over time and continues to evolve with input from those participants. Although not required by statute or regulation, in the past twenty years fairness opinions have become a regular feature of corporate control transactions and play an important role in helping directors to satisfy their fiduciary duties to act with due care and in an informed manner.[2] In many states, directors are entitled to rely in the performance of their duties upon the advice they receive from professional advisors, including financial advisors.[3] When fairness opinions are delivered to the boards of directors of publicly-traded companies, they are frequently disclosed (depending upon the form of transaction) in filings made by the parties to such transaction with the SEC.

SIA commends the NASD for undertaking a review of fairness opinion processes and the related disclosures made by member firms to the companies who retain them. However, we believe that a number of matters addressed in the Notice raise significant issues that, if the

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[2] See, e.g., Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

[3] See, e.g., 8 Del. C. § 141(e) ("A member of the board of directors . . . shall, in the performance of such member's duties, be fully protected in relying in good faith . . . upon such information, opinions, reports or statements presented to the corporation by . . . any other person as to matters the member reasonably believes are within such other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation"); N.Y. Bus. Corp. Law § 715 (McKinney 2005); and Cal. Corp. Code § 5231 (West 2005).

NASD ultimately determines to propose rules relating to fairness opinions, could have significant unintended adverse consequences. In particular, because the public disclosure of fairness opinions rendered to public companies who must seek stockholder approval in connection with change of control transactions is already subject to existing SEC rules and regulations, we believe that the NASD must be careful not to create rules that would conflict with or be inconsistent with the existing regulatory scheme applicable to such companies and such disclosures. It would be detrimental to the M&A process if new NASD rules caused member firms to become subject to disclosure requirements that differ from the disclosure requirements applicable to the recipients of fairness opinions. We also believe that the interests of all participants in the M&A process will be best served if all financial advisors who render fairness opinions, whether or not they are members of the NASD, are subject to the same set of disclosure requirements. Accordingly, SIA offers the following suggestions to aid the NASD in considering whether to propose rules relating to fairness opinions.

Identification and Disclosure of "Significant Conflicts"

Benefits of Relationships with Financial Advisors. The Notice suggests that there are "conflicts" in the fairness opinion process since financial advisors may be influenced by existing or prior relationships between such member firms and the companies who hire them, and therefore the Notice asks for comment on the appropriateness of a new rule to regulate the "identification and disclosure of conflicts" by member firms that provide fairness opinions.

Currently, when companies are seeking to retain advisors to assist them in providing financial and other advice in connection with structuring and negotiating change of control or other M&A transactions, they frequently retain financial advisors that have provided services to them in the past because companies see many benefits in retaining firms (and indirectly the professionals employed there) that already have experience in the relevant industry and are familiar with the company and its business, operation and financial position, and possibly the other party to the transaction. SIA respectfully submits that there is no per se "conflict" in hiring a member firm merely because that firm has existing or prior relationships with a particular company or another party to the transaction, and the NASD should not adopt any rule that might have the effect of discouraging companies from retaining financial advisors whom they believe are best qualified and whose judgments they most highly value to advise them with regard to a particular transaction by labeling those existing or prior relationships as "conflicts".

In addition, a company involved in a change of control or other significant M&A transaction typically believes it important to receive a fairness opinion from the financial advisor that has advised it on the relevant transaction because that advisor is most familiar with the process that has led to the transaction, the terms of the transaction, and the valuation issues that may be unique to that particular situation. Most companies want the financial advisor that has provided on-going valuation advice to them and that has assisted them in negotiating the financial terms of the transaction to provide a fairness opinion in order to demonstrate to the board of directors that the institution that participated in the negotiations is prepared to express its view that the final negotiated price or exchange ratio (in the case of stock-for-stock transactions) is fair from a financial point of view. Indeed, in many circumstances board members would be concerned if the financial advisor that advised the company on the transaction did not also provide a fairness opinion. While some commentators suggest that financial advisors are willing to provide a fairness opinion no matter what the terms are, those criticisms ignore the reality that the determination by a management team to present a potential transaction to a company's board of directors, and to request that a financial advisor provide a fairness opinion, is the culmination of an iterative process. In the course of its deliberations, a company may consider and discard many proposals and alternatives based, in part, on the advice from its financial advisor. When a management team is negotiating a potential transaction, or when it is considering whether to submit a transaction to its board of directors for approval, financial advisors do, in fact, advise companies when they would be unable to deliver a fairness opinion upon contemplated terms, and as a result, those transactions are either renegotiated or abandoned (usually before any disclosure is made to the public).

SEC Disclosure Requirements. Although the Notice requests comment on the appropriateness of a new rule to regulate the identification and disclosure of "conflicts" to companies, SIA respectfully notes that companies are already required to make extensive disclosures regarding fairness opinion providers and fairness opinions under existing SEC rules and regulations, as well as state common law disclosure requirements.

In particular, Item 1015(b) of Regulation M-A ("Item 1015") [4] requires companies to make the following disclosures regarding fairness opinion providers and fairness opinions:

> (b) *Preparer and Summary of the Report, Opinion or Appraisal*. For each report, opinion or appraisal described in response to paragraph (a) of this Item 1015 or any negotiation or report described in response to Item 1014(d) of Regulation M-A or Item 14(b)(6) of Schedule 14A concerning the terms of the transaction:
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> (1) Identify the outside party and/or unaffiliated representative;
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> (2) Briefly describe the qualifications of the outside party and/or unaffiliated representative;
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> (3) Describe the method of selection of the outside party and/or unaffiliated representative;
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> (4) Describe any material relationship that existed during the past two years or is mutually understood to be contemplated and any compensation received or to be received as a result of the relationship between:
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> (i) The outside party, its affiliates, and/or unaffiliated representative; and
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> (ii) The subject company or its affiliates;
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> (5) If the report, opinion or appraisal relates to the fairness of the consideration, state whether the subject company or

[4] 17 CFR § 229.1015 (Item 1015) Reports, opinions, appraisals and negotiations.

affiliate determined the amount of consideration to be paid or whether the outside party recommended the amount of consideration to be paid; and

(6) Furnish a summary concerning the negotiation, report, opinion or appraisal. The summary must include, but need not be limited to, the procedures followed; the findings and recommendations; the bases for and methods of arriving at such findings and recommendations; instructions received from the subject company or affiliate; and any limitation imposed by the subject company or affiliate on the scope of the investigation.

(*Instruction to Item 1015(b):* The information called for by paragraphs (b) (1), (2) and (3) of this Item 1015 must be given with respect to the firm that provides the report, opinion or appraisal rather than the employees of the firm that prepared the report.)

The detailed disclosures under Item 1015 are required in a number of different filings with the SEC that are frequently used in change of control transactions.[5]

NASD Rulemaking. Although SIA does not believe further regulation of disclosures is necessary,[6] SIA would not object to a properly tailored rule that complements the disclosures described above and would require member firms that provide fairness opinions in change of control transactions to identify and disclose to the boards of directors of companies any significant conflicts of interest. However, SIA further believes that because conflicts are so highly contextual and dependant on the facts and circumstances of a particular transaction and

5 See Schedule 14A, Item 14(b)(6) (Proxy Statement pursuant to Section 14(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")); Schedule 14C, Item 1 (Information Statement pursuant to Section 14(c) of the Exchange Act); Form S-4, Item 4(b) (Registration Statement under the Securities Act of 1933, as amended); and Rule 13e-3 Transaction Statement on Schedule 13E-3, Item 9 (for "going-private" transactions pursuant to Section 13(e) of the Exchange Act).

6 Numerous judicial decisions have dismissed claims against financial advisors alleging disclosure violations or breaches of fiduciary duty based on the presence of disclosures already required under Item 1015, which provide companies (and, ultimately, investors) with a basis on which to draw conclusions and evaluate the proposed transaction. In a recent decision regarding disclosure of prior relationships with a financial advisor, a court favorably noted that "the Proxy Statement adequately disclosed as potential conflicts of interest that [the financial advisor] had done work for [its client and the counterparty] in the past and might do business with [its client] in the future and that part of [the financial advisor's] fee depended on the success of the merger." Memorandum and Order of Partial Dismissal, Newby v. Enron Corp. Civ. Action No., slip op. at * 14-15 (S.D. Tex. Aug. 5, 2004).

the participants involved, the NASD should not endeavor to define in any proposed rule what arrangements or relationships constitute "significant conflicts of interest".

Contingent Fees. The Notice suggests that there is a "significant conflict of interest" if the member providing a fairness opinion earns a fee that is dependent on the success of the underlying transaction. Fee arrangements in M&A transactions are heavily negotiated by the companies who retain financial advisors, and in the experience of the members of SIA's Fairness Opinion Task Force, in most transactions it is companies—and not the financial advisors—that structure the fee arrangement to make all or a substantial portion of the fee contingent upon the closing of the transaction because the companies believe there are benefits to such contingent fee arrangements.[7] SIA agrees that fee arrangements, however structured, between a member firm giving a fairness opinion in a change of control transaction and a company should be disclosed to the board of directors and would support a well-tailored rule that would require member firms to disclose to the board of directors its specific fee arrangements in connection with the proposed transaction. However, SIA respectfully urges the NASD to refrain from suggesting that fee arrangements that are dependent on the success of the underlying transaction are per se problematic. SIA believes that any fee arrangement compensating a professional advisor for advice of any sort is potentially subject to criticism that there is an incentive to provide the advice that the client wants to receive, whether the fee is payable upon completion of services (or in the case of an M&A transaction, upon closing of the transaction) or at some earlier point in the engagement.

Timing and Manner of Disclosure. While many companies are aware of and already consider conflict or potential conflict issues when they select a financial advisor for a particular assignment, if the NASD were to propose rules relating to fairness opinions, SIA believes that the M&A process would be best served by a rule that generally requires member firms to disclose significant conflicts of interest to boards of directors either at or prior to the board meeting at which a fairness opinion is delivered. SIA further believes, however, that any NASD rule should not specify how or in what manner companies should receive this information; rather, member firms should be permitted to provide that information to the company's board of directors (or a committee thereof, as appropriate) at the time and in the manner the company and the member firm determine is appropriate for that particular transaction, consistent with the general obligation to provide such information at or prior to the meeting at which its fairness opinion is delivered, to the extent practicable.[8] It is important to

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[7] Courts have approvingly noted that contingent fee arrangements act as incentives for the financial advisors to seek the best available price in the transaction. *See* In re The MONY Group Inc. Shareholder Litigation, 852 A.2d 9 at 16 (Del. Ch. 2004) (MONY Group Inc. received a fairness opinion from a financial advisor, which was "incentivized to obtain the best available price due to a fee that was set at 1% of transaction value"); In re Vitalink Communications Corp. Shareholders Litig., 1991 WL 238816, at *10 (Del. Ch. Nov. 8, 1991), *aff'd sub nom*, Grimes v. John P. McCarthy Profit Sharing Plan, 610 A.2d 725 (Del. 1992) (highlighting a fee agreement as an incentive to seek the best available price).

[8] SIA notes that, in certain circumstances, complete information with regard to all of a member firm's disclosable relationships may not be known until the board meeting at

note that companies and not financial advisors control M&A transactions: companies determine when board meetings will be held and who will be permitted to make presentations to the board at any particular meeting. Any NASD rule that obligates member firms to disclose certain information on a pre-set calendar would potentially interfere with companies' control over the transaction.

SIA notes that the disclosure of significant conflicts of interest to a company's board of directors (or committee thereof) may differ from the disclosures required under Item 1015 that will appear in the related public disclosure document, which may not be prepared for weeks or months following the delivery of a fairness opinion. Accordingly, SIA respectfully suggests that the NASD not propose any rule that would require the highlighting of any differences in the two disclosures, provided that the public disclosure document includes appropriate disclosures as of that document's later date. Furthermore, in order to promote open disclosure between member firms and their clients, and in light of the fact that many member firms already make disclosures to companies about their relationships with the company and other participants in the transaction, there should be no presumption that any relationships or other arrangements so disclosed by a member firm to its client in fact constitute "significant conflicts of interest" within the meaning of any NASD rule or for any other purpose.

Disclosure Regarding Reliance on Key Information Supplied by a Company or its Management

The Notice requests comment on the need for a rule that would require disclosure by member firms of the extent to which they relied on key information supplied by companies and the firms' independent verification of such data.

As noted above, in arriving at fairness opinions, financial advisors rely upon the information that is provided to them during the course of a transaction, as well as upon publicly available information. If the NASD decides to propose rules relating to fairness opinions, SIA would be prepared to support a well-tailored rule requiring member firms to disclose whether or not such firms relied on certain information supplied by a company or its management and whether it independently verified that information. The members of SIA's Fairness Opinion Task Force are not aware of any member firms who currently assume responsibility for independently verifying information that they receive from companies or the counterparties to the transaction, and the fact that they do not assume such responsibility for independently verifying such information is typically a term of the engagement letters and also disclosed in

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which the fairness opinion is actually delivered, or possibly thereafter. In auctions, for example, where many potential buyers are approached, the identity of the counterparty may not be known until the very end of the process. In addition, the identity of the other principal participants in a transaction may change over time, such as when a "topping" bid is received after announcement of a negotiated transaction, or when an unsolicited bid is received.

fairness opinions. Significantly, many courts have accepted that financial advisors can disclaim responsibility for independently verifying information they receive from companies.[9]

SIA strongly believes that imposing on financial advisors (or other participants in the M&A process) a duty of verification would harm companies and the M&A process by causing significant delays, increasing risks of leaks of confidential and sensitive transaction information, and significantly increasing costs. As an initial matter, some of the information provided to financial advisors by companies in the transaction, such as financial forecasts, and other information that financial advisors rely upon in the preparation of fairness opinions, such as information about other companies and transactions that are used in comparable company and comparable transaction analyses, is simply not susceptible to independent verification. SIA respectfully notes that it does not believe that it would be appropriate for the NASD to propose a rule requiring member firms to verify information provided by companies and other parties to the transaction, as SIA believes that companies retain financial advisors to provide financial advisory services, such as financial analysis and strategic advice, and not to undertake independent verification of the information provided to them. SIA suggests that it is the responsibility of a company's management and board of directors to insure that the information provided to member firms as part of the fairness opinion process is accurate in all material respects.

Adoption of specific procedures member firms must follow in approving fairness opinions

The Notice suggests that a new rule could set forth "specific procedures that member firms must follow to guard against conflicts of interest in rendering fairness opinions."

SIA notes that its member firms currently use different procedures when approving fairness opinions due to differences in internal organization and structure. However, if the NASD were to propose rules relating to fairness opinions, SIA would be prepared to support a well-tailored rule that would require member firms to adopt, to the extent they have not already done so, written procedures that are generally designed to ensure an appropriate internal review of each fairness opinion. SIA anticipates that, if such a general rule were to be adopted, member firms would implement internal procedures (to the extent such procedures have not already been implemented or formalized) to ensure that, prior to delivery, each fairness opinion and the analyses underlying such opinion are reviewed and approved by individuals:

- who, in the in the reasonable judgment of the member firm, possess appropriate skills, knowledge and experience; and

- who are not members of the "deal team" working on the transaction that is the subject of the fairness opinion.

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9 *See, e.g.*, In re AOL Time Warner, Inc. Sec. & "ERISA" Litg., No. 1500, 02 CIV 5575 (S.D.N.Y. May 5, 2004); In re Reliance Sec. Litig., 135 F.Supp.2d 480 (Del. Ch. 2001); In re Global Crossing, Ltd. Sec. Litig., 313 F.Supp.2d 189 (S.D.N.Y. 2003); Goodwin v. Live Entertainment, Inc., Del. Ch., 1999 WL Del. Ch. LEXIS 5 (Jan. 22, 1999).

SIA's members include international investment banks as well as boutique firms; similarly, NASD member firms include all types of institutions. Therefore, any rule should provide each member firm with the flexibility it needs to best implement an effective and efficient procedure for reviewing and approving fairness opinions. Each member firm should be allowed to set its own procedures, including structuring its fairness committee as it deems appropriate and determining which analyses it will undertake in reviewing fairness opinions.

Evaluation of the degree to which the amount and nature of the compensation from the transaction underlying the fairness opinion benefits any individual officers, director or employees, or class of such persons, relative to the benefits to shareholders of the company

The Notice suggests that a new rule could require member firms to measure and consider how compensation from the underlying transaction benefits individual officers, directors or employees of the companies in the proposed transaction.

Of the many professional advisors and other parties who are involved in the M&A process, SIA believes that member firms are not best situated to evaluate the amount and nature of compensation that individual officers, directors or employees will receive from the underlying transaction, and SIA notes that not all member firms have the requisite knowledge or expertise to do so. These arrangements are often in place prior to the beginning (or even contemplation) of a particular transaction. SIA respectfully submits that the NASD should not mandate procedures requiring financial advisors to evaluate compensation arrangements. It would not ultimately enhance the M&A process to require member firms to second guess decisions and judgments previously made by companies' boards of directors, or to require member firms to take actions extending beyond their advisory role in M&A transactions.[10]

SIA is also concerned that substantive regulation of this type would require member firms to take actions that extend beyond their advisory role in M&A transactions, resulting in significant delay and the imposition of significant additional expense in the negotiation of mergers and acquisitions and other transactions. Boards of directors are already responsible for executive compensation decisions, including change of control payments, and boards of directors already have the ability to confer with numerous consultants regarding executive compensation arrangements, in general, and with regard to the compensation arrangements in a potential change of control transaction, in particular. In addition, current SEC rules already require extensive disclosure of the interests of specified executives and other persons in a proposed transaction.[11]

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10 SIA is not aware of any judicial decision holding as a matter of state law that a fairness opinion must include this type of analysis, or holding that a board of directors could not properly rely on a fairness opinion that did not include this analysis.

11 For example, Schedule 14A, Item 5 and Form S-4, Item 18(a)(5)(i) each require disclosure of the interests of certain persons in matters to be acted upon, including "any substantial interest, direct or indirect, by security holdings or otherwise" of directors and executive officers.

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We thank you for the opportunity to submit this comment letter. We would be pleased to discuss with you any of the comments described above or any other matters you feel would be helpful in your consideration of the issues raised in the Notice. Please direct any questions you may have regarding this letter to Scott C. Kursman of SIA at (212) 618-0508 or with our counsel to SIA's Fairness Opinions Task Force, David M. Schwartzbaum of Latham & Watkins LLP at (212) 906-1215.

Very truly yours,

John Faulkner
Chair, Capital Markets Committee

cc: Joseph E. Price, Vice President, Corporate Financing
Gary L. Goldsholle, Associate Vice President and Associate General Counsel

Fairness Opinion Task Force:

ABN AMRO Inc.
Banc of America Securities LLC
Bear, Stearns & Co. Inc.
Canadian Imperial Bank of Commerce
C.E. Unterberg, Towbin
Citigroup Global Markets Inc.
Credit Suisse First Boston LLC
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