



European - American  
Chamber of Commerce  
FRANCE

# European American Chamber of Commerce (France)



**HOULIHAN LOKEY HOWARD & ZUKIN**  
INVESTMENT BANKING SERVICES

## The New French Fairness Opinion Regime

*Mercredi 28 Juin 2006*

# Background and Basic Goals of the New Regulation

**Jean-Florent Rérolle, Houlihan Lokey**

The new regime will increase the number of fairness opinions (“attestation d’équité”) issued

**An opinion will be:**

**REQUIRED for target companies in the following instances:**

- Squeeze out
- Conflict of interests that can affect the Board’s objectivity
  - Offer for a majority-owned subsidiary
  - Prior agreement between the senior executives and the initiator
  - Transactions with related parties
- Unequal treatment between shareholders
- Discounted capital increase for certain new investors

**OPTIONAL in all other instances, with two possible options:**

- *Attestation d’équité*
- Independent Opinion or other fairness opinion

# Fairness opinion becomes a corporate governance tool

## Help the Board of Directors to improve its position

- Opinion focused on the offer and its consequences for the company, its shareholders, and employees
- An independent expert's report on the “financial conditions of the offer” is a key element on which the Board bases its decision

## Give shareholders an unbiased information

- Publication of the report in the offering memorandum for the target company
- Independent analysis of the transaction

## Review by the AMF: the “*déclaration de conformité*” examines the “financial conditions of the offer”

- Goes beyond a mere analysis of the offer price (multi-criteria approach)
- Independent expert's report is a key element
- The validity of the Board's opinion relies on the quality of the independent expert report

# A complete overhaul in the content of the Independent Expert assignment

## **The independent expert must perform a valuation (and not only a review of the bank report)...**

- Thorough due diligence required
- In depth review of the work undertaken by the investment banks and the underlying assumptions of the management business plan
- Valuation of the target company and the consideration

## **... and express its findings in an articulated manner**

- Consideration of the context of the transaction
- Structured reasoning
- Independent and unique point of view
- Specific information released to the market

# The new regulation strengthens the expert's mission

## **The new regulation set criterias for independence...**

- The expert must be able to exercise an objective and impartial judgment
- Numerous restrictions, such as a legal or ownership ties
- Declaration of expert's independence and adherence to a code of ethics
- Publication of expert's fixed fees

## **...competence...**

- Technical ability and capacity to properly conduct the work
- Insurance or financial strength

## **...and quality**

- Fairness Committee
- Review of the opinion by AMF

# Fairness opinion contributes to a better strategic decision

- **Improved information for the directors**
  - Diversification of information sources: independent analysis by a genuine third party
- **Enrichment of the debate among the board members**
  - Discussion of alternatives
  - Questions on risk and value
- **Improvement of the decision-making process**
  - Real contribution by the directors
  - Opportunity for directors to ensure there was no material oversight
- **Protection of the board of directors**
  - Increased vigilance and diligence
  - Decision made with all the available information
  - Demonstration of the quality and the integrity of board decision in a court situation
- **Guarantee of the quality of the process for investors**

# Recent Developments in US Fairness Opinion Practice

**Marjorie Bowen, Houlihan Lokey**

# History Overview

- In the US there is no “law” that requires a fairness opinion. Corporate governance is shaped by litigation precedent.
  - Smith v. VanGorkom - 1985, the Delaware Supreme Court
- Since Smith v. VanGorkom, boards have routinely used fairness opinions to demonstrate that they have acted on an informed basis.
- It is customary for a company to ask their investment banker to render a fairness opinion.
  - This “bundling” of services has historically been criticized but largely accepted.

# Recent Criticism and Regulatory Response

- Bundled services has led to criticism -- the parties who render fairness opinions stand to make significant fees, if and when the transaction closes
  - – the “contingent” transaction fee – or success fee – provides an incentive for a bank to render a positive opinion on a transaction that is otherwise unfair.
- Though this issue has existed for quite some time – there has been much recent scrutiny:
  - Elliot Spitzer - Spring 2003
  - NASD – 2004 Requests for Information, 2005 Proposes Rule 2290
  - SEC – 2006 Reviews Rule 2290 – process ongoing

## The “Solution” based on the NASD Proposed Rule

- Initially, the NASD has *proposed* a potential new rule that would require:
  - A “clear and complete” description of any “significant conflicts of interest” by the member (i.e. the opinion provider), including, if applicable, the nature of compensation that the member will receive upon the successful completion of the transaction.
  - Other disclosures relating to information and other procedural requirements.
- January 2005 – Comments to the NASD from investment banks, legal community, investors, and others:
  - The institutional investor community was in favor of tougher rules, more disclosure and elimination of fee conflicts.
  - The investment banking community responded, through the industry trade group known as the “Securities Industry Association” (or “SIA”), and advocated mostly the status quo.
  - The investment banking community was aided by the NY legal community – through the NY Bar and the City of NY Bar – both of which were generally against any enhanced disclosure.
  - Houlihan Lokey advocated enhanced disclosure for both fees in the aggregate, the timing of when fees are paid, and a clear description of the relationships that a banker has with all parties to the transaction.

## NASD Rule 2290

June 2005/November 2005 – The NASD published Rule 2290 – which then needed to be approved by the SEC. This rule required disclosure:

- If banker is going to receive a success fee, and render a fairness opinion, rule requires disclosure of such – BUT there is NO requirement for detailed or enhanced fee description.
- If banker has a “material” relationship with any party to the transaction it must be disclosed – BUT the concepts of “material” or “conflict” are not defined and the substance of the relationship (i.e. how much fee has been paid by each party to the bank) is not required disclosure.
- The rule does not prohibit investment banks from receiving contingent fees and rendering fairness opinions.
- Other aspects of the Rule address information that underlies the bankers’ analyses and internal bank procedures prior to rendering an opinion.

# SEC Review of NASD's Proposed Rule On Fairness Opinions – Spring 2006 and Other SEC Activity

- Similar to the NASD process, the SEC has solicited comments on NASD proposed Rule 2290
- The SEC notes:
  - The proposed Rule does NOT require member firms to quantify the amount of contingent fees that will be earned from either the client or others in the transaction.
    - Should the fee quantification be required?
  - The proposed Rule requires that a firm is to state if compensation is contingent.
    - Should be stated that a conflict may exist and a describe the impact of such conflict?

# The Latest From the US Courts

- TCI Decision - Delaware – Fall 2005
  - The courts criticized the use of a contingent fee fairness opinion provider
- NYSE / Archipelago Holdings Transaction
  - The courts and parties to the litigation utilized a fairness opinion to settle that litigation, that largely was pertaining to the price of a proposed transaction

## The Public Company Board Response – Second and Independent Opinions

- Boards are beginning to question independence of financial advisors and considering retention of separate financial advisors, including for the issuance of “independent” fairness opinions.
  - In the spirit of Sarbanes Oxley for the independent board members to have their own advisor
  - The “best practices” independent board members will hire their own advisor to assist them in understanding the transaction, evaluating the financial fairness, and ultimately opine
  - This is all disclosed to the shareholders in a proxy that gives this information to the shareholders

## Why Boards Perceive Conflicts

- Relationships that could cause boards to utilize a second/independent fairness opinion provider may include:
  - Contingent fee for primary advisor
  - Primary advisor's prior or ongoing relationship (potentially including lending or underwriting, or service provider) with counterparty or its affiliates
  - Primary advisor's prior or ongoing relationship (potentially including lending or underwriting, or service provider) with client company or its affiliates
  - Directorship and employee relationships
  - Stapled financing
  - Advisor's ownership interests (e.g., private equity investments; holder of different class of securities)

# The substance of a high quality, independent fairness opinion

- Independence is Key
  - In order to make informed decisions, the bankers undertake extensive financial analyses that are independent from any analyses that may be prepared by the company's management.
- Houlihan Lokey's analyses consider price and, to some degree, process.
- Price is evaluated based on an extensive fundamental value.
  - Due Diligence
  - Industry Expertise
  - Multi-faceted valuation analyses
- Process is also important, understand the genesis of any proposed transaction. A strong M&A background is required to assess and diligence:
  - Strategic alternatives analysis where the transaction is the value maximizing course?
  - Competitive process, or is it pre-emptive or unsolicited?
  - Other advisors involved or did the company alone facilitate the transaction?
  - Other advisors have a relationships / fee structure with either the company or the counter party?
  - Other alternatives that should be considered or re-considered that may create more value.

# Corporate Practices in the US and Europe

Eric Cafritz and Warren de Wied, Fried Frank



# European American Chamber of Commerce (France)



**HOULIHAN LOKEY HOWARD & ZUKIN**  
INVESTMENT BANKING SERVICES

## The New French Fairness Opinion Regime

*Mercredi 28 Juin 2006*