FAIRNESS OPINIONS AND LIABILITY

A Legal and Economic Analysis of Fairness Opinions in the United States and the Netherlands

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Preface

On December 1st, 2005 Sergei Parijs was awarded a PhD by the University of Groningen (the Netherlands) for his study Fairness Opinions and Liability, a Legal and Economic Analysis of Fairness Opinions in the United States and the Netherlands, supervised by Professors E.M. Kneppers-Heynert and L. Timmerman.

Fairness opinions have their origin in the United States' mergers and acquisitions practice, but in recent years have also been used in Europe. Fairness opinions can best be defined as an investment banker's assessment of the financial "reasonableness and equitableness" of a proposed offer for the target company's shareholders. In this clearly written book, Parijs investigates within the Dutch legal context how and why fairness opinions arise and what they might mean. His concentration lies primarily on fairness opinions of tender offers.

Parijs makes clear that there remains a great deal to be clarified as regards fairness opinions. Specific rules are largely missing. Parijs discusses various problems which arise from this, including conflict of interest amongst those who provide fairness opinions and the lack of an established valuation method. Most of these problems should be solved through self-regulation and Parijs presents some interesting proposals.

Dutch legal literature contains very little on fairness opinions. This book makes the subject accessible to Dutch legal professionals. One particularly useful aspect of this study is that Parijs not only makes interesting legal comparisons to important tenets of civil, corporate and securities law, but also to economic theories and valuation methods. This interdisciplinary, comparative legal approach makes this book a valuable resource for both legal professionals and academicians.

J.B. Wezeman

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Subject of the Thesis

1.1 Fairness Opinions

Over the last decades it has become common practice in tender offers for the prospective acquirer's bid to be supported by an investment banker's fairness opinion. Fairness opinions can be regarded as a corporate finance specialist's judgment as to the financial fairness of a takeover bid.[1] Although fairness opinions can be provided by any kind of financial adviser, in actual practice they are generally provided by investment bankers. The form and the contents of fairness opinions are not prescribed. It purely depends on the characteristics of the transaction in question how a fairness opinion is being shaped. This research is limited to fairness opinions that are provided with respect to corporate control transactions.

Usually fairness opinions in tender offers are provided at the request of the target company's board of directors. The reason why the target board requests a fairness opinion is to be able to judge whether or not it should support the bid and recommend it to the target shareholders. By means of a fairness opinion the target board aims to inform itself adequately in order to be protected against liabilities if the offer appears to be unfair. If the target board supports the prospective acquirer's bid, it draws up a recommendation letter which is inserted in the offer memorandum. An offer memorandum is meant to inform the target shareholders about all aspects of the takeover bid in question. If the target directors have based their recommendation on an investment banker's fairness opinion, the opinion is normally also publicized in the offer memorandum.

It may seem that obtaining a fairness opinion by the target directors is in the shareholders' interest, it does not, however, provide an absolute guarantee that the proposed offer is really fair to them. Fairness opinions have some problematic aspects that affect their reliability. For instance, there is practically no regulation

1. This is only a preliminary definition; in chapter 2, I discuss the definitions more extensively.

available that prescribes how a fairness opinion should be prepared, which gives providers wide discretion.[2] Moreover, providers are not required to show the shareholders how they arrived at their opinion; this creates a situation where the shareholders cannot verify whether or not the banker's judgment is accurate. Due to the lack of regulation on fairness opinions and of transparency by bankers, target directors may be able to persuade the shareholders to accept offers that are not entirely fair to them.

Apart from the question of whether or not fairness opinions give shareholders any comfort on the fairness of the offer, it is unclear whether shareholders are entitled to rely on fairness opinions at all. Usually, the target board obtains a fairness opinion in order to become adequately informed. In order to prevent shareholders from deriving any rights from their fairness opinions, bankers insert several kinds of disclaimers. It is questionable whether that does absolve them from liabilities towards the shareholders. Another liability issue concerns the question of whether or not the target directors can cover themselves against liabilities if they obtained a fairness opinion. One can wonder whether the directors can entirely shift their responsibilities to an outside expert.

Fairness opinions have their origin in the United States' mergers and acquisitions practice. In the late 1970s and early 1980s U.S. directors whose companies were acquisition targets started to request investment bankers provide fairness opinions.[3] At that time, requesting fairness opinions by target directors was based on custom. However, after the Delaware Supreme Court rendered its decision in the case *Smith v. Van Gorkom* in 1985, target directors in just about any corporate control transaction hired investment bankers to provide a fairness opinion.[4] In this case, the court held that target directors by means of a fairness opinion can protect themselves against liabilities for accepting inadequate takeover bids. By obtaining fairness opinions, the target directors are able to make better-informed decisions when they accept takeover bids, which may then, in turn, protect them against liability claims by shareholders. Although in practice target directors in any corporate control transaction request fairness opinions, in the United States the use of them is still not prescribed by law.

As a result of the internationalization of mergers and acquisition practices through cross-border mergers, fairness opinions have, in turn, become common practice in Europe. However, fairness opinions are directly adopted from the United States, which creates a situation where in Europe little is known about

2. Only in Canada is there regulation on fairness opinions in the Rule Book of the Investment Dealers Association of Canada (IDA); http://www.ida.ca/Files/Regulation/RuleBook/Rule Book_en.pdf (August 2005).
3. *See, e.g.* Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 Bus. Law 101, 102 n.4 (1979).
4. 488 A.2d 858 (Del. 1985).

their legal context. In this thesis I investigate the meaning of fairness opinions within the Dutch legal context. In order to be able to understand the motives for directors obtaining fairness opinions, I focus on the United States' legal system with respect to fairness opinions. The United States' practice may illuminate the extent to which fairness opinions give protection to Dutch directors. In this thesis, I also examine to what extent providers of fairness opinions can be held responsible if their opinions appear to be inaccurate. To answer whether or not providers under Dutch law can be held responsible, I first examine whether providers in the United States can be held responsible. Apart from the legal issues that are examined, I also pay attention to economic theories concerning mergers and acquisitions. The reason for dealing with economic theories is to get a better understanding of fairness opinions, which helps to answer the research questions in this thesis.

1.2 The Investment Banking Industry

As mentioned in the previous section, fairness opinions are usually provided by investment bankers. This section provides a global description of the investment banking industry and the way it is organized.

In contrast to lawyers and accountants, investment bankers are not considered as independent professionals (in Dutch: *"vrije beroepsbeoefenaren"*); individual bankers, who are employees of a bank, tend to operate under the name of the investment bank. As a result, the investment bank as an institution is primarily responsible for the individual investment bankers' conduct. Another difference with respect to lawyers and accountants is that investment bankers do not have representative organizations that submit their members to a code of professional conduct. Currently, neither the American Bankers Association nor the Netherlands Bankers' Association *("Nederlandse Vereniging van Banken")* have codes of professional conduct.[5]

The investment banking industry is not a homogeneous industry. On the one hand, some general banks have corporate finance departments that provide fairness opinions. On the other hand, there are also specialized merchant banks that provide fairness opinions. In the Netherlands, ABN Amro, which is a general bank, provides many fairness opinions. In the United States, however, specialized merchant banks like Goldman Sachs, Morgan Stanley and J.P. Morgan provide most of the fairness opinions. In order to avoid confusion, in this thesis I do not make a distinction between different kinds of banks.

5. *See* Ted J. Fiflis, *Responsibility of Investment Bankers to Shareholders*, 70 Wash. U. L. Q. 497, 515 (1992). They also lack standards of practice; *See Investment Banker Liability: Transcription of a Panel Discussion*, 16 Del. J. Corp. L. 557, 570 (1991).

Investment banks not only provide fairness opinions but may also provide additional services with respect to corporate control transactions. Apart from providing fairness opinions, they may also act as adviser to the target's board (or acquiring company). Other functions may include being financer of the acquisition, auctioneer, as well as supervisor of the issuance of securities in stock-paid acquisitions. In some corporate control transactions, the investment bank may have conflicts of interests because it combines several functions in one corporate control transaction. An example of this is the investment bank both advising the target company and arranging the financing of the acquisition on behalf of the acquirer.[6] In other situations, investment banks may pitch for assignments by conceiving corporate control transactions themselves.[7] In order to secure an assignment, they approach prospective acquirers to suggest acquiring a specific target with their assistance.

The role of an investment banker in a particular corporate control transaction largely depends on the transaction in question and the companies involved. Frequently, the companies involved hire a bank that is familiar with the company and its business; for example, the bank may be the company's principal bank or a main creditor.[8] Other motives for hiring a particular investment bank are, for example, its well-established market reputation, its independent position in the transaction at issue, and its expertise with respect to the transaction at issue.

Notwithstanding all other motives for the target board to hire a particular investment bank, the most important motive is its credible market reputation. A fairness opinion from a well-established investment bank inspires confidence to the target's shareholders that the proposed offer is being carefully reviewed. It also helps the target board persuading the shareholders to accept the offer. A bank's credible reputation may provide comfort to the shareholders that its fairness opinion is accurate. This gives banks, in turn, an incentive to provide well-prepared fairness opinions.

1.3 Fairness Opinions in the Netherlands

In the Netherlands, fairness opinions were introduced for the first time in 1990 for the merger of ABN Bank and Amro Bank. The companies' managing directors and supervisory directors jointly obtained a fairness opinion rendered by the

6. *See Eigen Goal,* Het Financieele Dagblad, December 28,2004. With respect to the takeover of PinkRoccade, ABN Amro Bank was both adviser of the target and financed the takeover bid by Getronics. Ordina, who also wanted to acquire PinkRoccade, was advised by ING Bank, which would supervise the issuance of new stock to finance the transaction.
7. *See* Helen M. Bowers & Robert E. Miller, *Choice of Investment Banker and Shareholders' Wealth of Firms Involved in Acquisitions,* 19 Financial Management 34, 35 (1990).
8. *Id.*

American investment bank Goldman Sachs.[9] It was the first time in the Netherlands that, apart from the companies' auditors, an outsider had been requested to value both the merging companies.[10] In early 1991, Goldman Sachs also provided a fairness opinion with respect to the merger of Nationale-Nederlanden and NMB Postbank, which is currently named Internationale Nederlanden Groep (ING). From that moment obtaining fairness opinions by managing directors and supervisory directors of merging companies also became a common feature in the Netherlands' merger and acquisition practice. Because fairness opinions are directly adopted from U.S. merger and acquisition practice and have only been applied for the last 15 years, explains that little is known about fairness opinions in the Netherlands.

Apart from the fact that fairness opinions have only been known for the last 15 years, there are yet more explanations why there is so little (legal) foundation for fairness opinions. Only since the mid 1980s has legislation on security trade been developed in the Netherlands. Insider trading, which has been prohibited since 1989 with the introduction of Section 336a in the Dutch Criminal Code, may serve as a good example; before the introduction of this provision, it was not illegal to benefit from insider information.[11]

The development of securities law in the Netherlands has itself developed in two ways. On the one hand, there has been self-regulation by the stock exchange (Euronext Amsterdam), which is further developed by provisions laid down by or pursuant to acts. On the other hand, there has also been supervision (mainly disciplinary) by the stock exchange in which the government, although it has stayed on the background, has had the final say. Eventually the government took over responsibility for this supervision and has transferred its public-law supervisory tasks for the most part to the Authority for the Financial Markets (AFM).[12] At this time, due to the transfer of tasks to the AFM, the regulatory competence and supervising authority of the stock exchange are rather limited. The scope of the powers remaining concern matters pertaining to the listing of public companies,

9. In the Netherlands, companies are required to have a two-tier board structure if the statutory two-tier rules apply: this means they need to have a management board and a supervisory board. The position of the members of the management board is comparable to the position of the executive directors in the one-tier board system. The position of the supervisory board members is comparable to that of the non-executive directors in the one-tier board system. In section 3.7.1, I deal with this topic more extensively. With respect to the Netherlands, when I use the term "target directors" I mean both the managing directors and the supervisory directors. Only with respect to legal matters, a distinction is made between managing directors and supervisory directors.
10. *ABN/AMRO zetten trend met advies Goldman Sachs,* Het Financieele Dagblad, July 19, 1990.
11. Act of February 2, 1989 (Bulletin of Acts and Decrees 1989, 16), date of entry into force: February 16, 1989. Currently, insider trading is regulated by Sections 46-46d of the Securities Transactions Supervision Act 1995 (STSA 1995) *("Wet toezicht effectenverkeer 1995").*
12. S.E. Eisma, *Inleiding, in* S.E. Eisma et al., Leerboek effectenrecht, (2nd ed. 2002), 8-9.

which lies mainly in the domain of private law.[13] However, under a new legislative proposal on unfair dealing on the financial markets, the remaining supervisory tasks of the stock exchange are also destined to be transferred to the AFM.[14]

The regulation of the securities market started in 1985 with the introduction of the Securities Transactions Act *("Wet Effectenhandel")*. Initially the stock exchange kept its supervisory tasks pertaining to stock exchange dealings. In 1992 the Securities Transactions Act was replaced by the Securities Transactions Supervision Act *("Wet toezicht effectenverkeer")*, which in 1995 was, in turn, replaced by the Securities Transaction Supervision Act 1995 (STSA 1995) *("Wet toezicht effectenverkeer 1995")*: the latter is currently still in effect. In 1999 many of the remaining supervisory tasks of the stock exchange were transferred to the AFM. As from January 1, 2000, the AFM has been handed the authority for charging financial penalties and imposing periodic penalties. However, the stock exchange's supervisory tasks with respect to the supervision of listed companies were only transferred to the AFM on August 1, 2005. In the 1990s the provisions regulating insider trading were transferred from the Criminal Code to the STSA 1995.[15] The large number of new Acts that have been introduced in the last 20 years illustrates the immature state of securities law in the Netherlands.

The STSA 1995 manages to regulate the offering of securities and brokering securities services, asset management, and tender offers.[16] The STSA is applicable in both the primary and the secondary market. The primary market is concerned with the issuing of securities, for example, initial public offerings (IPO); the secondary one is concerned with the trading of securities. Breaching the provisions of the STSA can be sanctioned by administrative financial penalties. The Securities Transaction Supervision Decree 1995 (STSD 1995) *("Besluit toezicht effectenverkeer 1995")* deals more specifically with the subjects that the STSA 1995 regulates. For instance, the STSA 1995 prohibits bringing out takeover bids without making available an offer memorandum, whereas tender offers themselves and the way offer memoranda should be drawn up are described in detail in the STSD 1995. A breach of the provisions of the STSA 1995 is generally considered as committing a minor offence under Section 1(2) Economic Offences Act *("Wet op de economische delicten")*. The supervision necessary for the observance of the provisions of the STSA 1995 (and the STSD 1995) is conducted by the AFM. The development of securities law in the Netherlands is not only

13. The relationship between the stock exchange and the listed companies are embodied in the Listing and Issuing Rules *("Fondsenreglement")*.
14. Legislative proposal 29 827 *("Wetsvoorstel marktmisbruik")*.
15. *Id.* at 10.
16. A.C. Metzelaar, *Primaire markt, in* S.E. Eisma et al., Leerboek Effectenrecht, (2nd ed. 2002), 81.

induced by national developments but also by European directives whose aim is to align legislation on securities law within the E.U. member states. This simplifies investment by foreigners in Dutch companies, which is in the Dutch national interest.

The fact that fairness opinions are not regulated in the Netherlands is due not only to the late rise in securities law. The topic of fairness opinion in fact covers three separate legal areas: securities law, corporate law, and liability law. This may have resulted in fairness opinions not attracting the attention of the legislator and the supervising authorities.

Under Section 9q(2)(a) STSD 1995 the target's management board has the obligation to inform the shareholders about the takeover bid. Furthermore, the management board has to define its position vis-à-vis the bid: it has to make public whether or not it supports the bid. By obtaining a fairness opinion the management board is able to define its position. In order to show that the target company supports the bid, the management board and the supervisory board frequently insert a jointly written recommendation letter directed to the shareholders in the offer memorandum. As mentioned in the previous section, if the target's management board in its recommendation refers to a fairness opinion, that also will be inserted in the offer memorandum. These provisions are in the nature of securities law. Corporate law regulates the target board's decision-making process and prescribes what duties the board members have vis-à-vis the shareholders. In this context a fairness opinion serves to support the board's decision and may help them to evade possible liability claims by disappointed shareholders. This brief description shows that there is no real distinctive difference between securities law and corporate law. It follows, therefore, that in some countries certain topics are considered to lie in the domain of corporate law, whereas in other countries the same topic is considered to be part of securities law.[17] As a rule of thumb it may be stated that securities law relates to the regulation of listed companies' external obligations towards the stock market and corporate law relates to internal obligations within the listed company itself.

Having described the development of Dutch securities law and the legal position of fairness opinions, in the following subsections, I will discuss three Dutch takeovers in which fairness opinions played a remarkable role. These cases illustrate that fairness opinions can be used for various purposes in corporate control transactions and thus these cases further illustrate that they currently have no solid foundation.

17. *See* J.W. Winter, *De bijzondere positie van de beursvennootschap in de systematiek van het Nederlandse venootschap, in* J.W. Winter et al., De beursvennootschap 4 (2001).

Tessag/Smit Trafo

The takeover of the Dutch company Smit Trafo in 2000 by the German company Tessag illustrates that investment banks that provide fairness opinions may have severe conflicts of interest when they fulfill different functions in the takeover process. In this particular takeover, ABN Amro Bank acted as Smit Trafo's financial adviser and also provided a fairness opinion on Tessag's offer. Meanwhile, the bank was also the majority shareholder of Smit Trafo: it owned 59 percent of Smit Trafo's shares. Apart from that, the bank was one of the company's creditors.[18] The reason why the bank had become the majority shareholder had an unusual origin. In 1994, the bank supervised the IPO of Smit Trafo's shares. However, the IPO was not very successful because shortly after the IPO it appeared that the issue prospectus had depicted Smit Trafo's situation too optimistically. This information made investors sell their shares collectively, which made the share price drop dramatically. In order to avoid legal proceedings, the bank offered the shareholders the chance to repurchase the shares at the issue price. The bank, however, was still of the opinion that it had not informed the investors inaccurately and that it had not depicted Smit Trafo's situation too optimistically; Smit Trafo was of the same opinion. The reason for the bank compensating the investors was that it felt itself "highly involved and responsible for the orderly course of events on the Amsterdam Stock Exchange."[19]

In 2000, Tessag made a tender offer bid on Smit Trafo's outstanding shares; it offered € 9, which was a premium of 37 percent over the average price in the year prior to the offer.[20] In 1994, six years prior to the tender offer, the issue price had been *f* 45, which corresponds nowadays to approximately € 20. If one compares the issue price and the offering price, the offering price seems to be mediocre. However, a premium of 37 percent is quite acceptable, especially for a company with a negative image. As mentioned above, the bank combined many different functions; however, it has not been said that it had harmed investors. The bank assisted Smit Trafo during the negotiations with Tessag and also provided a fairness opinion; this combination does not guarantee the impartiality of the fairness opinion. However, because the bank was the majority shareholder and had granted loans to Smit Trafo, its own interests were also at stake. Therefore, it is unlikely that it would have accepted an inferior price.[21] Another reason why the bank is likely to have accepted a reasonable price is because of reputational damages that the bank could have suffered as a consequence of accepting an inferior takeover bid. Because the bank compensated the investors after the IPO, and had an interest in obtaining a good price in the tender offer, the investors were probably not harmed by the conflict of interests. However, in order to avoid reputational damage, banks should not have these kinds of conflicts of interest.

18. *ABN Amro heeft vuiltje bijna weg,* Het Financieele Dagblad, September 10, 2000.
19. *Bank compenseert koersval Smit Trafo. ABN Amro betaald, maar bekent geen schuld,* Het Financieele Dagblad, July 18, 1995.
20. *Duits stroomconcern haalt Smit Trafo van de beurs,* Het Financieele Dagblad, August 3, 2000.
21. *ABN Amro heeft vuiltje bijna weg,* Het Financieele Dagblad, September 10, 2000.

Vodafone Group/Vodafone Libertel

In 2003, in the tender offer by Vodafone Group for the outstanding shares of its Dutch subsidiary Vodafone Libertel, a new phenomenon appeared; in this tender offer, the target's management board had obtained an "unfairness opinion." This particular takeover was not only a curious case because it was the first time in the Netherlands that an unfairness opinion was provided, but all the more because Vodafone Group already owned 77.6 percent of Vodafone Libertel shares.[22] According to the Vodafone Libertel management board, the offer of € 11 per share by the British parent was inadequate and therefore it did not support the offer. In the opinion of the Vodafone Libertel management board, the offer did not "reflect the company's actual value."[23] Analysts were of the opinion the company was worth € 13.50 to 16.50 per share: a considerable difference. For this reason, the board refrained from recommending the offer to the shareholders. However, the target board did not prevent the company from being taken over because it did not regard the takeover as "hostile." The parent company, on the other hand, was not prepared to raise the offer; the offer was to remain at € 11 or else it would be withdrawn. The reason why Vodafone Group itself found the offer "reasonable and equitable" was because the offer included a premium over the market price of 35.6 percent over the last 12 months prior to the offer.[24] The Vodafone Libertel management was in an uncomfortable position because a management board that does not support a takeover bid should not cooperate with the acquirer but oppose it. Under normal circumstances the target's management board should have defended the company and its shareholders against the acquirer, or at least have attempted to obtain a better offer for the shareholders. In this case, the situation was a little different because Vodafone Group already owned almost 80 percent of Vodafone Libertel shares and was still expanding its shareholding by buying shares on the stock exchange at prices below € 11. If Vodafone Libertel had not cooperated, Vodafone Group would have withdrawn its offer. As a consequence, the remaining shareholders would have been left in a minority position, which has a depreciating effect on the price of the shares. In that case, Vodafone Group would only have had to wait until the price decreased considerably, and then it could have bought the remaining shares on the stock market. In the present situation, the Vodafone Libertel board, however, handled the situation well, because

22. *See* G. van Solinge, *Ondeugende dochters*, Ondernemingsrecht, 201 (2003).
23. *Bod Vodafone op dochter Libertel zeer onzeker,* Het Financieele Dagblad, February 8, 2003.
24. *Vodafone houdt vast aan bod op dochter Libertel,* Het Financieele Dagblad, February 13, 2003.

it did what the law requires them to do: represent the shareholders' interests by trying to obtain the best price under the circumstances at the time.

Hawkslease Finance Company/EVC International

The third curious case is the tender offer by Hawkslease Finance Company Limited for the outstanding shares of EVC International, which took place in 2003. At the time the offer was made, the acquirer already owned 75 percent of EVC shares. The offer memorandum, dated February 6, 2003, revealed that the EVC directors did not agree on whether to recommend the offer. Therefore, the EVC directors provided an advisory statement concerning the offer in which the disagreement clearly appeared: each member had to explain his position with respect to the offer. The directors, in fact, were forced by the AFM to present such an advisory statement. According to the AFM, the shareholders under Section 9q(2) STSD 1995 had the right to receive an explanation for the directors' motives in not supporting the offer.[25] Directors being so divided on an offer, like the EVC directors were, is rather unique because directors are used to finding a way to reach consensus on an offer. In a situation like this, directors run the risk of the tender offer not being successful, which may harm the public shareholders: the acquirer already owned 75 percent of EVC's shares. Like the tender offer bid on Vodafone Libertel, if the offer had not succeeded, the shareholders would have been left in a minority position. Another interesting aspect of this takeover is the fact that the EVC directors did not obtain a fairness opinion. In the event that target directors cannot reach mutual agreement, trying to obtain a fairness opinion may either support their views or show the shareholders that the offer is fair. The reason why the directors did not request a fairness opinion was because EVC had a high level of borrowing and a volatile earnings record, thereby making the share price and stock market very volatile and, lastly, there was much uncertainty in the world economies within which EVC was active. Both the management board and the supervisory board were of the opinion that they could not justify incurring the significant cost associated with obtaining an independent opinion, which according to them would be of questionable value. Although it is understandable why the boards did not request a fairness opinion, the explanation that a fairness opinion would have been of questionable value is hard to understand. Especially in situations in which directors do not reach mutual agreement on the fairness of a proposed offer, requesting a fairness opinion could show investors that the directors had good reasons for supporting the takeover bid or not.

Both the Vodafone Libertel case and the EVC case are atypical for Dutch merger and acquisition practice. Usually, the directors reach consensus with respect to

25. *Directie EVC verdeeld over overnamebod van Ineos,* Het Financieele Dagblad, February 7, 2003.

tender offer bids, especially when it concerns a takeover by the parent company. Nevertheless, both these cases show that something has changed; directors tend to be more critical with respect to takeover bids even when it concerns a "buy-out" by the majority shareholder. Presumably, directors, due to corporate scandals, have become more apt to be critical and defend shareholders' interests properly. Maybe due to these scandals, directors, in particular supervisory directors, are wary that they might be held personally liable by investors. A bank having conflicts of interest like the bank in the Tessag/Smit Trafo takeover probably will not occur very frequently in future takeover situations.

Up until now, in the Netherlands, no investment bank or director has as yet been held liable for rendering inaccurate fairness opinions or recommending an "unfair" takeover bid. This may result from the fact that only in a small number of cases has the fairness of a bid been questioned; in most cases a considerable premium over the market price is offered, which, in turn, may indicate the offer is fair. If investors are of the opinion that an offer was not fair and that the fairness opinion was inaccurate, they have the burden of proof unless they base their claims on the misleading publicity regulation: Sections 6:194-195 Dutch Civil Code (DCC). In applying this regulation, the burden of proof is reversed to the defendants. However, because so far no liability claims stemming from inaccurate fairness opinions have been based on the misleading publicity regulation, it is not clear whether or not it applies to fairness opinions.[26] If the misleading publicity regulation is not applicable, shareholders will have problems in substantiating their claims because they will not be able to gather relevant information to produce the required evidence. However, in the Netherlands courts do have the discretionary power of being able to reverse the burden of proof onto the defendant, if "reasonableness and fairness' require so: this is not a general rule courts have to apply.

1.4 Relevance of the Research

Currently, in the Netherlands, little is known about the effect of obtaining fairness opinions by target directors. By obtaining a fairness opinion, target directors assume they are protected against liability claims for accepting inadequate takeover bids. However, since fairness opinions are directly adopted from the United States mergers and acquisitions practice, it is doubtful whether they fit into the Dutch legal system. In addition, it is also unclear to what extent shareholders are entitled to take fairness opinions into account in considering whether or not to accept a proposed takeover bid. If directors cannot protect themselves

26. In the literature it is assumed that the misleading publicity regulation applies to fairness opinions. *See, e.g.* J.M. van Dijk, *Aansprakelijkheidsvragen rond fairness opinions*, TVVS, 318 (1998).

against liabilities and shareholders are not entitled to take them into account, fairness opinions do not benefit anyone except the persons providing them: fairness opinions might as well be abolished. This research aims at clarifying whether or not fairness opinions do add anything to the Dutch merger and acquisition practice. Moreover, due to its liberal system of corporate law, occasionally the Netherlands, rather pretentiously, is called the "Delaware of Europe."[27] In order to make good this flattering designation, it would not do any harm if in the Netherlands a coherent line of policy was developed with regard to fairness opinions, something which is currently lacking. If my study can contribute to the development of such a view, I would consider the writing of this thesis a success.

1.5 Objectives and Research Questions

The main objective of this research is to make clear what purposes fairness opinions have to target directors in the Netherlands and to what extent target shareholders can derive rights from them. The second objective is to clarify what persons or institutions can be held responsible if a fairness opinion appears to be inaccurate. The research questions that can be derived from these objectives are:

1) Should Dutch law require that target directors obtain fairness opinions in corporate control transactions?
2) Are investment bankers to be regarded as gatekeepers who safeguard the target shareholders' interests?
3) Can fairness opinions lessen information asymmetries between the target company's shareholders and the directors?
4) Is legislation and supervision with respect to fairness opinions required in order to protect the shareholders' interests properly?
5) Can directors of Dutch target companies successfully protect themselves against liability claims for recommending unfair takeover bids by obtaining fairness opinions?
6) Can the target's shareholders hold investment bankers liable if their opinions prove to be inaccurate?
7) Are the target company's shareholders entitled to take fairness opinions into account when they take a takeover bid into consideration?

27. Other nicknames are "Delaware on the North Sea" and "Delaware on the Rhine." *See* J.H.M. Willems, *De Ondernemingskamer in rechtsvergelijkend perspectief*, Ondernemingsrecht, 545 (2003); P. Quist, *Nederland nog geen Delaware aan de Rijn*, Het Financieele Dagblad, May 13, 2004; and M.J. Kroeze, *Het Delaware van Europa?*, Ondernemingsrecht, 565 (2004).

1.6 Thesis Outline

Although developments in other European countries may be interesting for the understanding of fairness opinions and their legal spectrum, fairness opinions are mainly an American topic. For this reason, although I briefly deal with some Canadian regulation, I have limited this research to the United States. Another, more pragmatic motive for limiting this research to the United States is the presence of an abundance of literature on the American practice, which is missing with respect to other countries.

Another limitation placed on this research is the scope of application of fairness opinions. Although they can be applied in any transaction in which third-party interests are involved, I have limited the research to tender offers. The reason for limiting the research to tender offers is that fairness opinions are mostly applied in these kinds of transactions. In addition, because of the possible presence of conflicts of interests in tender offers, there is much room for discussion, which makes it a more interesting topic of investigation.

Since fairness opinions are generally provided by investment bankers, in this thesis I only pay attention to investment bankers. For this reason no attention is paid to the implications involved if other financial advisers such as accountants provide fairness opinions.

Chapter 2 deals with some definitions of fairness opinions and the functions of fairness opinions. I will also describe their appearance and their contents. In Chapter 3, I will present the theoretical framework of fairness opinions and deal with some corporate governance issues with regard to fairness opinions. In addition, I will examine whether or not fairness opinions can be considered as monitoring instruments for shareholders. Chapter 4 deals with the problematic aspects of fairness opinions and the question of whether or not they should be adjusted in order to be a monitoring instrument. In Chapter 5, the techniques investment bankers use in evaluating a target company are examined. This examination aims to provide understanding as to whether a fairness opinion can help the shareholders reduce information asymmetries and make a balanced decision. In Chapter 6, I will assess whether or not target directors can protect themselves against liabilities by requesting a fairness opinion. I will also assess to what extent shareholders can hold the providers of inaccurate fairness opinions liable. Finally, in Chapter 7, the research questions of this study are presented once more and answered briefly.

The manuscript was finished at the end of August 2005. Publications that have appeared after this date are only occasionally taken into account.

Chapter 2

Fairness Opinions: An Introduction

2.1 Introduction

In this chapter, I will define fairness opinions and assess their functions, contents and appearance. Section 2.2 deals with different definitions of fairness opinions used by several authors. From these definitions, I have derived my own definition that will be applied in the remaining chapters of this thesis. In this section, I will also draw comparisons between fairness opinions and other expert opinions. In section 2.3, attention is paid to the types of transactions in which fairness opinions are most often applied. Section 2.4 deals with the different elements of which fairness opinions are composed. In section 2.5, attention is paid to the mutual relationships between the parties involved in a tender offer. Section 2.6 deals with hostile takeovers and the motives of the target company's board of directors hiring an investment banker to provide a fairness opinion. Finally, section 2.7 deals with the functions of fairness opinions.

2.2 Defining Fairness Opinions

2.2.1 Definitions

In legal literature, different definitions for fairness opinions are applied. In this section, I will examine several of them. At the end of this section, I will present a definition, derived from the literature, which will be the definition used henceforth in this thesis.

Giuffra defines fairness opinions as:

> "a judgment by an investment banker as to the financial fairness of the terms of a corporate control transaction."[1]

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1. Robert J. Giuffra Jr., Note, *Investment Bankers' Fairness Opinions in Corporate Control Transactions*, 96 Yale. L.J. 119, 120 (1986).

The definition Martin uses is:

> "Fairness opinions are 'short letters that state an opinion about whether the consideration in a proposed transaction is 'fair' to the shareholders from a financial point of view."[2]

Block and Hoff use the following definition:

> "A 'FAIRNESS OPINION' is an independent analysis provided by a financial expert, usually an investment bank, stating that firm's belief regarding the 'fairness' or 'adequacy' to the corporation or its shareholders of a proposed corporate transaction."[3]

According to Van Dijk, a fairness opinion is:

> "a well respected bank's statement, which – based on limited-scaled investigation – is of the opinion that the price or exchange ratio offered is 'reasonable and equitable.' "[4]

The final definition I will examine is derived from Bowers; she defines fairness opinions as follows:

> "A fairness opinion, typically presented in the form of a letter to the board, contains the issuer's opinion regarding the fairness or adequacy to the corporation or its shareholders of the financial terms of a proposed transaction."[5]

Giuffra's definition of fairness opinions is correct in my opinion; however, according to him a fairness opinion is a judgment on the financial fairness of the terms of a corporate control transaction. I am of the opinion that fairness opinions only state whether the proposed price (or exchange ratio) is fair to the shareholders from a financial point of view; fairness opinions usually do not assess whether the terms of the merger or acquisition are fair. On the second definition

2. Michael W. Martin, *Fairness Opinions and Negligent Misrepresentation; Defining Investment Bankers' Duty to Third-Party Shareholders*, 60 Fordham L. Rev. 133, 137 (1991). For a similar definition: Michael Schuldt, *A Statutory Proposal for the Regulation of Fairness Opinions in Corporate Control Transactions*, 56 Mo. L. Rev. 103, 103 (1991).
3. Dennis J. Block & Jonathan M. Hoff, *Reliance on Fairness Opinions*, N.Y.L.J., June 16, 1994, 5.
4. J.M. van Dijk, *Aansprakelijkheidsvragen rond fairness opinions*, TVVS, 318 (1998): definition translated from Dutch.
5. Helen M. Bowers, *Fairness Opinions and the Business Judgment Rule: An Empirical Investigation of Target Firms' use of Fairness Opinions*, 96 Nw. U. L. Rev. 567, 569-70 (2002).

by Martin, I have no remarks. The definition by Block and Hoff is correct but only in theory. In practice, the provider of a fairness opinion is not always an independent party in the transaction. As I mentioned in Chapter 1 (Smit Trafo/Tessag case), banks may fulfill several functions in a takeover, which may result in conflicts of interest. Although it is not desirable for a bank to have conflicts of interest, there are no rules that prohibit banks from having them. Van Dijk's definition in my opinion is correct. The definition given by Bowers is also correct but fairness opinions usually do not make a judgment as to the consequences to the corporation of a proposed transaction. Fairness opinions only make a judgment as to the fairness of the price that the target shareholders are offered. In my opinion, fairness opinions in corporate control transactions can be best defined as:

> An investment banker's assessment as to the financial "reasonableness and equitableness" to the target shareholders of a proposed offer.

2.2.2 Investment Banker Fees

The position of investment bankers who provide fairness opinions is mainly determined by the structure of the fee they receive. Investment bankers may receive fixed fees that are agreed to in advance and are not dependent on the consummation of the transaction. However, bankers frequently receive their fees only if the transaction in question is consummated; this is a so-called "contingent fee." In a contingent fee arrangement, the bank may receive a fee dependent on the company's sale price.[6] In other fee arrangements, the banker's payment is dependent, for example, on a raider's failure in a proxy contest, on the bank's recruitment of a "white knight," or on the target company's making the fairness opinion public.[7]

The kind of fee arrangement depends on the underlying relationship between the bank and the client. If the bank is only requested to provide a fairness opinion and does not deliver other services to the client, it most likely receives a fixed fee. However, if the bank also provides financial advice or other services, it often receives a contingent fee. Usually, when the bank in question receives a contingent fee, it is disclosed in the fairness opinion. The main motive for making fees contingent on the consummation of the transaction is based on the belief that

6. *Id.* at 38. The amounts of the fees investment bankers receive are not clear. According to Kennedy, investment banks frequently receive a percentage fee of any eventual transaction, usually around 1% in a medium-sized transaction, and a much smaller fee for delivery of a fairness opinion, usually between $ 500,000 and $ 1,000,000 in a medium-sized deal; M.J. Kennedy et al., *Functional Fairness – The Mechanics, Functions and Liabilities of Fairness Opinions*, Technology & Emerging Growth M&A's 265 (2002).
7. Lucian Arye Bebchuk & Marcel Kahan, *Fairness opinions: How Fair Are They and what Can Be Done about It?*, 38 Duke L. J. 27, 38-39 (1989).

investment bankers will then work harder to make sure the transaction is completed. Moreover, it is assumed that a contingent fee arrangement stimulates bankers to obtain a better price, which is also beneficial to the shareholders.[8] Although there are positive effects from contingent fee arrangements, it may give bankers conflicts of interest. A banker whose payment depends on the consummation of the transaction, and who is both adviser to the target company and the provider of a fairness opinion, has an incentive to provide a positive fairness opinion if the sale price of the target is unfair. By refusing to provide a positive fairness opinion, the proposed transaction is likely not to be consummated; this means the banker will not be receiving payment for his efforts. Contingent fee arrangements may affect an investment banker's independent position, which may severely harm the target shareholders' interests. In Chapter 4, I will deal with this problem in more detail.

2.2.3 Costs of Fairness Opinions

Usually in friendly takeovers, it is the target company's board of directors that hires an investment banker to provide a fairness opinion. This means the target company is the banker's actual client and is the one who pays for the opinion. Let us assume that a fairness opinion in a fictional medium-sized takeover costs € 1,000,000.[9] By paying for the fairness opinion, the target company's equity becomes worth less by the same amount. As a result the prospective acquirer will be prepared to pay € 1,000,000 less for the target. This actually means that the target's shareholders are paying for the fairness opinion. The costs per shareholder depend on the total number of outstanding shares and the number of shares a particular shareholder owns. If the target has 10,000,000 outstanding shares, the costs of a fairness opinion contribute only € 0.10 per share. This amount is negligible if the shareholders for instance receive € 30 per share instead of € 30.10 per share.

Although the costs of fairness opinions per share are not worth mentioning, it is odd that the shareholders are paying for something that they did not ask for themselves. Moreover, it is not entirely clear to what extent shareholders may rely on fairness opinions in deciding whether or not to accept a takeover bid. In this respect it is questionable whether the costs of fairness opinions can be justified to the shareholders.

2.2.4 Similar Statements

Fairness opinions at first glance bear some resemblance to lawyers' third-party legal opinions and accountant's reports in legal mergers. Both are expert state-

8. *Id.* at 49.
9. *See* Kennedy et al., supra note 6.

ments that, like fairness opinions, are in a way prepared for the benefit of third parties that are not contractually bound. Apart from the fact that they resemble fairness opinions, liability questions are more likely to be answered in the same way. However, in this thesis I will not be discussing the applicable liability regime of third-party legal opinions and accountant's reports.[10] The main reason for dealing with these two expert statements is to prevent their being confused with fairness opinions.

2.2.4.1 Third-Party Legal Opinions

In many important international, and also national, business transactions the parties involved require legal opinions as a condition precedent to the consummation or closing of the transaction.[11] Legal opinions, in this context, are "written opinions delivered by a lawyer at the request of his own client to another party to the transaction or to the client itself."[12] A legal opinion is not to be considered as a recommendation but as a judgment or statement as to the presence and the validity of the legal status and legal relationship of the topic in question. The opinion is based on the facts or factual assumptions and may contain certain qualifications as to the legal judgment or statement.[13] Legal opinions can be regarded as: "a tool of risk management by the parties to a contract because they address all relevant legal risks inherent in the contract."[14] If the lawyer provides his client with the opinion, it is called a "client opinion."

Legal opinions can also be provided to third parties, for example, to the party with whom the client enters into contract, then it is called a "third-party legal opinion." The meaning of a third-party legal opinion is that a contracting party can rely on the lawyer's statement without conducting an investigation himself as to the legal aspects of the contract. In actual practice, the party that has to obtain an opinion requests that its own lawyer provides one. Because the opinion is provided for the benefit of the other party involved in a transaction, the lawyer has to be impartial in providing his opinion.[15] As I mentioned above, obtaining a legal opinion can be a precondition for closing a contract; if the party that has to provide an opinion is not able to provide one, the transaction may well be cancelled.

10. The main reason for not discussing liability aspects of third-party legal opinions and accountant's reports is the availability of the American literature on liability with respect to fairness opinions which may provide inspiration for solving liability questions under Dutch law: this makes a discussion about liability aspects redundant. The liability aspects of fairness opinions are discussed in Chapter 6 of this thesis.
11. M. Gruson et al., Legal Opinions in International Transactions 8 (3rd ed. 1997).
12. *Id.*
13. *See* D.C. Meerburg, *De juridisch adviseur en bescherming van derden-beleggers – De advocaat in spagaat?, in* A. Schilder et al., Het advies en de rol van de adviseur 158 (2004).
14. Gruson et al., *supra* note 11, at 8.
15. *See* E.J.A.M. Van den Akker, Beroepsaansprakelijkheid ten opzichte van derden 112 (2001).

The reason why third-party legal opinions are generally requested in international transactions is to enable the receiving party to properly evaluate the legal risks involved in the transaction. The receiving party needs a legal opinion because he may not be familiar with the law in the country of the other party. In actuality, a legal opinion is a tool to enable the receiving party to assess whether or not he should enter into a contract. In corporate control transactions purchasers of (target's) shares frequently require the seller to provide legal opinions. It provides the purchaser with the assurance that the shares are duly authorized and validly issued, that he has, in fact, acquired the shares he bargained for, that the shares acquired, in fact, represent the desired percentage of the target company, and that the acquired shares are free of liens and assessments.[16] Other aspects that may be covered by legal opinions are, for example, whether or not the target company is duly incorporated and thus validly existent, whether or not the transaction in question constitutes any violation of law, and whether or not the target company is involved in litigation. A legal opinion can be considered as a supplement to due diligence investigations, and, in so doing, serves to diminish the risks involved for the prospective acquirer.[17]

The rationale behind requiring a legal opinion from the other party's lawyer is that his lawyer is usually more familiar with the issues covered by the opinion and his opinion reinforces his client's representations.[18] For example, with respect to a corporate control transaction, the selling party's lawyer has more knowledge of his client's business than an outside lawyer; moreover, he has better access to important information. Another possible advantage of third-party legal opinions over client opinions is that if the opinion seems to be defective, the receiving party will be less hesitant to hold the provider of the opinion liable than he would his own lawyer.[19]

The scope of persons that may rely on a lawyer's opinion depends on the extent to which the lawyer knows or should have known that they belong to a group of persons for whose benefit the opinion was intended under these particular circumstances.[20] To these persons the lawyer has a "duty of care." This means that not every person that coincidentally obtains a legal opinion may rely on it. The persons that may rely on the opinion (addressees) have to act in good faith if they base certain decisions on it. This implies that the addressee has the duty to investigate to what extent the opinion is reliable: a legal opinion may not be regarded as an absolute guarantee.[21] The extent to which an addressee may rely on a legal

16. Gruson et al., *supra* note 11, at 5.
17. *See* M. Brink & G.T.M.J. Raaijmakers, *Beroepsaansprakelijkheid en legal opinions*, Ars Aequi, 466 (1995).
18. Gruson et al., *supra* note 11, at 11.
19. Brink & Raaijmakers, *supra* note 17, at 468.
20. Meerburg, *supra* note 13, at 161.
21. Brink & Raaijmakers, *supra* note 17, at 472.

opinion is dependent on the choice of words; the more absolute, the more the opinion tends to be a guarantee.[22] In order to limit the group of persons that may rely on the opinion, the lawyer in his opinion mentions expressly which persons are entitled to rely on his opinion. In contrast to fairness opinions, legal opinions are not publicized in public information documents such as offer memoranda. However, even if a legal opinion were to be made public, because of the limited scope of persons who are entitled to rely on the opinion, not every investor should blithely rely on it.

One major difference vis-à-vis fairness opinions is that legal opinions only concern legal matters on which the addressee desires a professional's opinion; fairness opinions only take financial aspects of a proposed transaction into account and do not say anything about the legal aspects of a transaction. Moreover, legal opinions are applicable between the parties that enter into a contract. Fairness opinions are applied by the target company in relation to the recommendation of the offer by the directors to the shareholders: the target company is not party to the main agreement. The main agreement in a tender offer is concluded between the prospective acquirer and the target shareholders. The only actual similarity between third-party legal opinions and fairness opinions is that an (outside) expert provides an opinion on a transaction that has implications for one of the parties involved.

2.2.4.2 Accountant's Report in Legal Mergers

In legal mergers, under Section 2:328(1) DCC, Dutch law requires the management board to hire a register accountant to examine the merger proposal and certify whether in his opinion the proposed stock exchange ratio is reasonable.[23] The accountant must also certify whether the sum of the shareholders' equity in each of the amalgamating companies (companies ceasing to exist) at least corresponds to the nominal paid-up amount on the aggregate number of shares to be acquired by their shareholders under the merger. In examining the merger proposal, the accountant must state whether the applied valuation methods are in accordance with generally accepted valuation methods.

The accountant's report in legal mergers consists of two separate statements. In his first statement the accountant has to state whether or not the proposed exchange ratio of the stocks offered is reasonable. The reason why he must state this is to protect the shareholders of the amalgamating companies. In assessing the exchange ratio, the accountant does not necessarily need to issue a positive statement; he may also state that in his opinion the offer is unreasonable. Should the opinion as to the merger turn out to be that it is not reasonable, the shareholders are still free to resolve to accept the merger. In practice, however, if an

22. *Id.*
23. Section 2:328(1) DCC; *See* Appendix 2.

accountant provides a negative report, both the merging companies will draw up a modified merger proposal.[24]

In his second statement, the accountant has to state that the sum of the shareholders' equity in each of the amalgamating companies is equal to or more than the aggregate nominal value of the issued shares plus any cash payments. The accountant may only provide a positive certification or else he must refrain from providing any. If the accountant refuses to provide his certification, the merger has to be cancelled.[25] The intent behind this second statement is to prevent non-substantial capital from being contributed to the company, thus protecting the company's shareholders and its creditors.

It is prescribed by law that the accountant's report in legal mergers is to be inserted in the explanatory memorandum (in most cases in the offer memorandum) that both the merging companies shareholders have to make available to their shareholders. The intention of the accountant's report in legal mergers is to prevent the acquiring company from going on to issue shares at a higher nominal amount than is equivalent to the value the company receives in exchange. The value to the shareholders of an accountant's report is not necessarily to show that the proposed exchange ratio is fair to them, but rather to show the shareholders that the (newly established) company in which they will become shareholders really has substantial equity. An accountant's report therefore cannot be regarded as a kind of fairness opinion, which is purely meant to show that the proposed offer is fair to the target shareholders.

2.3 Practice Area (Type of Transactions)

Although law does not require directors to obtain fairness opinions in corporate control transactions, practice shows that directors in the vast majority of transactions do request an investment banker to provide a fairness opinion.[26] Fairness opinions can be applied in practically any kind of corporate control transaction. Examples of transactions are: negotiated mergers; freeze-out mergers; legal mergers; (hostile) tender offers; self-tender; management buyouts; leveraged buyouts; negotiated share repurchases; and negotiated sales of treasury stock.[27]

24. J.M.M. Maeijer, Asser-Maeijer 2-III: Vertegenwoordiging en rechtspersoon § 580 (2nd ed. 2000).
25. *Id.*
26. Block & Hoff, *supra* note 3, at 5.
27. Bebchuk & Kahan, *supra* note 7, at 27. Companies that have Employee Stock Owner Plans (ESOPs) may also request a fairness opinion if the company is involved in a corporate control transaction. The fairness opinion then is provided to the ESOP trustees of the selling company. By introducing an ESOP, the company's employees become shareholders of that company. Having an ESOP may be very convenient for companies that are the subject of a hostile takeover because it can be regarded as an anti-takeover measure. If the proposed takeover is friendly, the employee-shareholders need to approve the transaction.

However, these transactions are mostly applicable to the United States and do not occur all over Europe. The reason why these transactions mostly occur in the United States is because the United States' merger and acquisition practice is much more developed than the European practice and it has had fewer legal limitations to carry out certain types of transactions. An example is the leveraged buyout, which cannot be carried out in the Netherlands. The reason is that in leveraged buyouts, outside entities purchase the shares of publicly owned companies primarily with borrowed funds. The assets of the company in question are often used as collateral.[28] In the Netherlands, under Sections 2:98c(1) and 2:207c(1) DCC, publicly owned companies and private companies are not allowed to provide security, or otherwise warrant the performance of or bind themselves jointly and severally or otherwise in addition to or for others if this is done for the purpose of allowing others to subscribe to or acquire shares in their capital. In the remaining part of this section, I will not be making a distinction between the United States and the Netherlands; I will mainly focus on the United States.

In going-private transactions, smaller shareholders of a corporation are compelled to accept cash for their shares while larger shareholders retain their shares.[29] The purpose of going-private transactions is to end the marketability of the shares of the company involved; afterwards the company is no longer publicly owned.[30] Transactions that fall under going-private transactions are, for example, management buyouts and leveraged buyouts. In a management buyout, the company's directors buy all stocks that are held by minority shareholders (usually private investors). By means of a management buyout, the directors become the owners of the company. The leveraged buyout is a kind of takeover in which the outside buyer acquires the shares of the target company with borrowed funds. Frequently, the target company's assets are given as collateral for the borrowed capital. A management buyout can also be a leveraged buyout and vice versa.

With respect to going-private transactions, in the United States, the SEC, under Rule 13e-3, requires that directors disclose information as to whether the issuer (directors) believes the transaction to be fair to the minority shareholders. The issuer therefore must disclose on Schedule 13E-3 the material factors upon which

28. If the management has a significant financial and participatory interest in the outside entity, the transaction may be referred to as a management buyout; Hamilton, The Law of Corporations, 654 (5th ed. 2000). *See* A.R. Pinto & D.M. Branson, Understanding Corporate Law 237 (1999).
29. Hamilton, *supra* note 28, at 651.
30. Under going-private transactions, the SEC understands that a company reduces the number of its shareholders to fewer than 300 and is no longer required to file reports with the SEC; http://www.sec.gov (August 2005).

that belief is based and the weight assigned to each factor.[31] In order to fulfill this requirement, the SEC allows the directors to request a fairness opinion. Under Rule 13e-3, directors may also provide other kinds of valuations as long as the consideration depicted is true and fair to the shareholders. The most important aspect of Schedule 13E-3 is that a fairness opinion has to be disclosed if the directors have obtained one.[32]

The reason why the SEC requires the directors in going-private transactions to disclose information on the fairness of the consideration that the shareholders receive, is that directors may have interests conflicting with those of the shareholders. On the one hand, the directors have to protect the shareholders' interests by obtaining the highest price possible for them, while, on the other hand, it is in their own interest to pay as little as possible because they are the buyers of the shares. To lower the price the directors will have to pay to take over the company they may attempt to depress the market value of the stock by making imprudent business decisions or by not pursuing viable corporate opportunities.[33] In order to reduce the conflict of interest between the directors and the shareholders, the directors often establish a special committee of disinterested directors to evaluate the proposed buyout offer.[34] A special committee is better able to protect the shareholders' interests. If the directors have established a special committee, the committee, instead of the directors, can hire an investment banker to provide a fairness opinion; this may help to avoid the semblance of a conflict of interest.

Apart from going-private transactions, the application of fairness opinions in corporate control transactions has become common practice. If a target board decides not to request a fairness opinion, it may create the impression that the takeover bid is unfair because no investment banker was prepared to provide an opinion. If the target's board of directors does not want a transaction to be questioned, it is better off requesting that an investment banker renders a fairness opinion. As I mentioned above, fairness opinions can be applied to practically any type of corporate control transaction. In order to limit the scope of this study, I will only be discussing fairness opinions that are provided in tender offers. The reason for this limitation is not only pragmatic, there is also a substantive reason. Tender offers are by far the most interesting transactions to examine because they

31. Bill Shaw, *Resolving the Conflict of Interest in Management Buyouts*, 19 Hofstra L. Rev. 143, 154 (1990); H. Peter Nesvold, *Going Private or Going for Gold: The Professional Responsibilities of the In-House Counsel During a Management Buyout*, 11 Geo. J. Legal Ethics 689, 707 (1998). SEC Schedule 13E-3, Items 8 & 9, 17 C.F.R. § 240.13e-100 (2000); http://www.sec.gov/divisions/corpfin/forms/13e3.htm (August 2005).
32. William J. Carney, *Fairness Opinions: How Fair Are They and Why Should We Do Nothing About It*, 70 Wash. U. L. Q. 523, 529 (1992).
33. Shaw, *supra* note 31, at 147-48.
34. *Id.* at 155.

may contain a fierce conflict of interest between the target directors and the shareholders. Transactions that come under tender offers are takeovers or mergers.[35] Only if other kinds of transactions present interesting views on fairness opinions will they be discussed.

2.4 Contents of Fairness Opinions

Usually a fairness opinion is a letter which is generally addressed to the board of directors of the target company. With respect to the contents, practically all fairness opinions are drawn up in the same way. However, the order of the contents and the paragraphs can differ to some extent. The length of a fairness opinion usually varies between one and three pages. In Canada fairness opinions may be considerably longer and may consist of twenty pages. This results from the presence of specified rules on valuation and fairness opinions which are enacted by the Investment Dealers Association of Canada (IDA). These rules require providers of fairness opinions to present extensive valuations and thus prescribe what information a fairness opinion must contain.[36] Other countries, including the United States and the Netherlands, do not have any regulation on fairness opinions, which explains their brief length. Fairness opinions from these two countries are usually drawn up in the same way and consist of the following elements:[37]

1) The opening words of a fairness opinion mention to what persons it is addressed; in most cases it is addressed toward the board of directors.[38] The main reason why the fairness opinion is addressed to the board of directors is because it has to form an opinion on the reasonableness and fairness of the takeover bid. A fairness opinion may support the board's own views. The second reason for addressing fairness opinions to the board of directors is that it may serve as a means of defense for the board in the event it is held liable for

35. Buyouts (going-private transactions) are also included in the discussion because they are mostly carried out by means of a tender offer.
36. Investment Dealers Association of Canada Rule Book 2001, Rule 29.14 to 29.25; http://www.ida.ca/Files/Regulation/RuleBook/RuleBook_en.pdf (August 2005).
37. Leland H. Goss, *Fairness Opinions: The US Experience*, *in* Current SEC & Cross-Border M&A Developments 386-92 (1999); *Investment Banker Liability: Transcription of a Panel Discussion*, 16 Del. J. Corp. L. 557, 584-85 (1991) (remarks of Saul Cohen); Block & Hoff, *supra* note 3.
38. In countries that have two-tier board systems, fairness opinions are directed toward the management board and the supervisory board jointly. A rare exception is the fairness opinion by ING Bank on the tender offer bid by Scania for Beers. This fairness opinion is one of the few occasions where the bank directed its fairness opinion to the shareholders of the target company. Moreover, the opinion consists of an explicit recommendation to the shareholders that they accept the takeover bid because they have, according to the bank, "no practical alternative."