Fairness Opinions in M&A Transactions

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A board of directors evaluating a potential M&A transaction is faced with a multitude of decisions. One question that must be addressed is whether the proposed transaction is a “good deal” for the shareholders of the company. While directors, many of whom are experienced business professionals, likely have an idea of what they “feel” their company is worth, it is unlikely that they are trained in business valuations. This is where a fairness opinion can aid a board of directors both in guiding their decision-making process and ensuring that they are making an informed decision.

Director Duties

In the context of an M&A transaction, directors should be especially mindful of the general legal standards against which their conduct will be evaluated. A director’s duties are generally defined by the statutory law of the jurisdiction in which their company is organized, as interpreted by judicial decisions. In North Carolina, for instance, the North Carolina Business Corporation Act provides that a director should discharge his or her duties (1) in good faith, (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances, and (3) in a manner he or she reasonably believes to be in the best interest of the corporation. In discharging these duties (commonly called the duty of care), a director may rely on information, opinions, reports, or statements (including financial statements and other financial data) if prepared or presented by financial advisors as to matters the director reasonably believes are within such financial advisors’ professional or expert competence.

What is a Fairness Opinion?

A fairness opinion is a letter addressed to the board of directors prepared by a professional advisor experienced in valuing securities and business enterprises. In the M&A context, the crux of the opinion often is that the acquisition consideration is fair, from a financial point of view, to the shareholders. If the opinion is to the target company’s board, then the opinion addresses the consideration to be received by the shareholders pursuant to the definitive acquisition agreement. If the opinion is to the buyer’s board, then the opinion addresses the consideration to be paid by the buyer corporation pursuant to the terms of the definitive acquisition agreement. The opinion letter itself is often short, commonly two or three pages. It is usually delivered to the board by the financial advisor immediately prior to the board taking action to approve entering into a definitive acquisition agreement. Customarily, the financial advisor delivers a detailed fairness presentation to the board, which
substantiates the conclusion reached in the opinion, immediately prior to delivering the written fairness opinion letter.

**Reasons to Obtain a Fairness Opinion**

While a fairness opinion is not required by law, a board of directors, particularly on the sell side, can find it useful for a number of reasons. First and foremost, in exercising its duty of care, the board of directors should take reasonable actions to make an informed decision about entering into an M&A transaction. A fairness opinion from a qualified financial advisor can serve as evidence that the board did so, and validate the board’s decision to enter into an M&A transaction. While the opinion will not address the board’s underlying decision to approve the transaction (nor opine whether it is preferable to other strategic alternatives), it will provide evidence that in reaching its decision, the board negotiated terms that were fair, from a financial point of view, to the corporation’s shareholders. By receiving the opinion from an independent party, the board shows it exercised diligence in making its decision and performed a type of “market check” to further satisfy itself that the consideration to be received by the shareholders was, as of the date of the opinion, within the range of values that a firm experienced in such matters would consider fair.

Additionally, in the litigious environment in which all U.S. businesses operate, the opinion often serves as the first line of defense against potential claims that the transaction was not in the best interest of shareholders. It is no secret that when an M&A transaction is announced, particularly if it involves a target company that is publicly traded, there are plaintiff’s firms lined up to take on potential shareholder claims that the target’s board did not properly exercise its fiduciary duties in determining whether to enter into the transaction. While a fairness opinion is not a silver bullet by any means, and is no substitute for a board making an informed, well-reasoned decision, the absence of an independent fairness opinion likely would be one of the first points of attack for a plaintiff’s firm trying to demonstrate that the board did not make a fully informed decision that was in the best interest of the shareholders.

**Other Considerations in the Fairness Opinion Process**

The decision to go ahead and obtain a fairness opinion in connection with a strategic transaction is just the first step. Below are some additional data points to consider in the process:

- **Selection of an Independent Third Party for the Opinion.** It is often advisable that the target’s board select a professional firm to render the fairness opinion that is different from the financial advisor who advised and represented the target in the negotiation of the acquisition agreement. When a target engages a financial advisor to render advice regarding strategic alternatives, including pursuing an M&A transaction, the structure of the financial advisory engagement is often a contingency fee arrangement, where all or a substantial portion of the advisor’s fee is contingent (i.e., only payable) upon successful completion of a transaction. To avoid the appearance of a potential conflict of interest, engaging a separate firm to provide the fairness opinion adds independence, since the third party would not have a substantial fee payable only if the transaction is consummated.
• **Timing of the Opinion.** As previously mentioned, a fairness opinion is usually rendered to the board immediately prior to entering into a definitive acquisition agreement, and the opinion only speaks as of the date it is given. In many cases, particularly in regulated industries such as the banking industry or in a transaction that may require other regulatory review or third-party consents resulting in a delay between signing the definitive acquisition agreement and closing, the time period that may elapse between when the opinion is given and when shareholders may actually vote on the transaction may be significant. The board should consider whether to ask the advisor to provide a “bring down” of the opinion to a more current date, particularly where market dynamics may have changed, such as a significant increase (or decrease) in premiums being paid in comparable transactions. Such “bring down” opinions are less common in our experience, but in certain circumstances such an opinion could add value.

• **Cost vs. Value.** While a board and company management are generally rightfully concerned about the cost of a fairness opinion, the old maxim that “you get what you pay for” applies. The board should select an experienced advisor and one that specializes in the industry in which their company operates. If the opinion is attacked on its merits, a board facing a legal challenge likely will feel that the extra cost for an appropriately qualified advisor was money well-spent. Additionally, a company’s shareholders, to the extent the opinion is described in a proxy statement mailed to shareholders to solicit votes to approve a transaction, often use the opinion’s analysis as one factor in determining how to vote. The shareholders deserve the benefit of the expertise of a qualified advisor.

**Conclusion**

A fairness opinion can play an important role in an M&A transaction. A board of directors that is considering exploring a significant business combination should consult with both their legal and financial advisors early to determine the benefits that such an opinion might offer for the company in the M&A process.

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