

NCEO

NATIONAL CENTER FOR  
EMPLOYEE OWNERSHIP

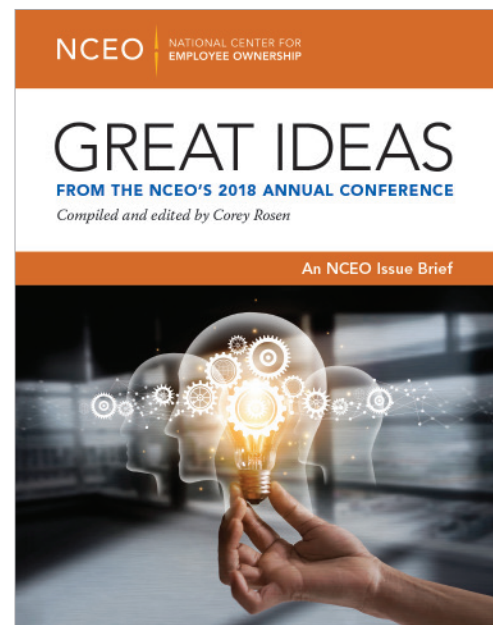
# Fairness Opinions

*David Solomon and Andy Smith*

**REPRINTED FROM**

Great Ideas from the NCEO's  
2018 Annual Conference

Get it at [www.nceo.org/r/great2018](http://www.nceo.org/r/great2018)



Fairness opinions can be a legal tool to assist corporate directors and/or ESOP trustees in making or approving decisions concerning strategic and financial events involving the ESOP and/or the company sponsoring the ESOP and ensure satisfaction of relevant fiduciary duties. It provides a fiduciary with financial information regarding the pending transaction. Finally, it can instill confidence among stakeholders that an action has been thoroughly vetted for its effects on the ESOP and/or the company sponsoring the ESOP.

The following is a summary of some of the events that may give rise to the need for a fairness opinion:

- The sale and/or issuance of stock to a newly forming ESOP.
- The sale of a significant portion or substantially all of the assets or stock of an ESOP company.
- The incurrence of significant debt or the financial restructuring (“recapitalization”) of an ESOP company.
- The purchase or sale of a significant asset or business segment that is beyond the normal scope of business or corporate activity.
- The liquidation of the ESOP company/termination of the ESOP.
- The redemption of stock by the company from non-ESOP shareholders.
- Changing the business entity type of the ESOP company (S corporation election).
- The commitment of the company to shareholder agreements that place future obligations on the company.
- Significant changes in compensation or other financial practices (particularly if such changes are different or contrary to the financial construct upon which a transaction value or ongoing plan valuation is based).

Fairness opinions are not the same as valuations. Appraisals are based on a specific standard of value, usually “fair market value,” and are constructed using the assumptions of a hypothetical and rational universe. A fairness opinion examines the specific terms and context of a transaction. While a valuation of the transacting interests may be an essential underpinning

## Fairness Opinions

*David Solomon, Levenfeld Pearlstein; Andy Smith, McLean Group*

Many transactions involving an ESOP-owned company require a fairness opinion. A fairness opinion is an opinion as to whether the transaction, taken as a whole, is fair and reasonable from a financial point of view. A fairness opinion represents the judgment of an independent and experienced professional applying recognized principles of valuation about the fairness of the financial terms of a transaction.

for a fairness opinion, it is not the only substance of a fairness opinion. Fairness opinions contain additional disclosures, observations, and assessments concerning the circumstances of, alternatives to, and other key factors surrounding a transaction.

Although a fairness opinion can be a critical part of the trustee's analysis of a particular transaction, it does have limitations. A fairness opinion is not:

- An opinion or any other form of assurance that the highest and best possible price is being obtained or received for a given transaction;
- An assessment or evaluation of the negotiation process leading to the proposed transaction;
- An evaluation of the business rationale regarding the proposed transaction;
- An opinion of the legal fairness of the proposed transaction;
- A recommendation to the fiduciary on how to vote; or
- A confirmation of, or any form of opinion or assurance (whether audit, review, or compilation) on, historical or prospective financial statements or any other information provided by or on behalf of the client or obtained publicly.

In determining the fairness of a transaction, the financial advisor should consider both "aggregate" fairness and "relative" fairness. "Aggregate" fairness is based on the amount of the entire compensation to be received in the transaction. For example, the financial advisor may compare the price per share to be received in a merger or acquisition transaction to the concluded range of value per share estimated by the financial advisor. "Relative" fairness comes into play when certain transaction parties will receive special consideration (e.g., an ownership interest in the surviving company, payment for an agreement not to compete with the surviving company, or a lucrative employment contract). In determining relative fairness, the financial advisor may consider the relative investment risk accepted by each party in a transaction and the expected investment return associated with that risk.

The final product of a fairness opinion is typically delivered in the form of a letter. The content of the

fairness opinion letter generally contains the following elements:

- The purpose and objective of the fairness opinion.
- A description of the proposed transaction.
- A list of the documents and agreements that were relied on and any additional due diligence performed.
- Appropriate caveats regarding significant assumptions or conditions.
- A statement on significant limitations on use.
- A formal conclusion as to whether the proposed transaction is fair from a financial point of view.

A detailed description of the financial and valuation analysis performed by the independent financial advisor in order to render the fairness opinion is often presented to the client in a separate oral/written presentation.

In sum, the existence of a fiduciary duty and potential conflicts of interest are usually a key indicator that a fairness opinion may be beneficial in a transaction. A fairness opinion is often a protection mechanism for future litigation. Finding an advisor who is knowledgeable of the industry and the litigation process is an important consideration in choosing a fairness opinion provider. Avoid real or perceived conflicts that can reduce the defensibility of a fairness opinion by engaging an independent advisor.