



INTERNATIONAL VALUATION STANDARDS COUNCIL

EXPOSURE DRAFT

Procedural Guidelines for Fairness Opinions

Comments on this Exposure Draft are invited before 31 May 2012.

All replies may be put on public record unless confidentiality is requested by the respondent. Comments may be sent as email attachments to: CommentLetters@ivsc.org or by post to **IVSC, 41, Moorgate, London EC2R 6PP, United Kingdom.**

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Introduction to Exposure Draft

A Fairness Opinion is an opinion on whether the financial terms of a proposed corporate transaction such as a takeover, merger or sale of part or all of a business are fair to the shareholders of the entity concerned. They are often commissioned by the directors or other fiduciaries of an entity in order to demonstrate that they are acting in the interests of all shareholders. In some jurisdictions, they are required by statute or regulation for specified types of transaction.

Providing an opinion of the fairness of a transaction from a financial perspective usually requires a valuation or valuation analysis. Valuations that form part of a fairness opinion are generally capable of being undertaken in accordance with the International Valuation Standards (IVS) and other pronouncements of the IVSC, for example the *Code of Ethical Principles for Professional Valuers* or the guidance on valuation methods provided in various Technical Information Papers.

The IVSC Professional Board considers it in the public interest to issue procedural Guidelines for preparing fairness opinions to indicate the specific issues that generally need to be addressed in accepting and progressing an assignment to prepare a fairness opinion and how these relate to the provisions of the IVS. The objectives of the proposed Guidelines are to:

- provide specific illustration of threats to a fairness opinion provider's objectivity to supplement the IVSC Code of Ethical Principles for Professional Valuers;
- enable preparers and users of fairness opinions to more readily ensure that the valuations on which the opinions are based meet the requirements of transparency of process and reporting contained in the IVS;
- to provide those who rely on fairness opinions with the assurance that the valuations on which the opinion is based, have been prepared in accordance with recognised international norms.

The views of providers, users and others who rely on fairness opinions on this Exposure Draft are especially welcome.

Questions for respondents

The IVSC Professional Board invites responses to the following questions. Not all questions need to be answered but, to assist analysis of the responses received, please use the question numbers in this paper to indicate to which question your comments relate. Further comments on any aspect of the Exposure Draft are also welcome.

Notes for respondents:

- 1 Responses should be made in letter format, where appropriate on the organisation's letter heading. Unless anonymity is requested, all comments received may be displayed on the IVSC website.
- 2 Comments should not be submitted on an edited version of the Exposure Draft.
- 3 It is most helpful if comment letters are submitted by email in an unlocked pdf format file so that comments can be extracted for analysis. Documents will be secured before being placed on the IVSC web site.

Questions

- 1 The Board recognises that, in many jurisdictions, laws or regulations exist that govern when a fairness opinion is required, who may provide the opinion and matters that the opinion has to address. As indicated in the preamble to the proposed Guidelines, they are intended for use where there are either no equivalent statutory requirements or to supplement statutory requirements where these are silent on matters addressed in the Guidelines. While some jurisdictions may have more prescriptive or additional requirements to those proposed in the Guidelines, the Board is interested in knowing if any of the proposals conflict or contradict national regulatory requirements.

Do these Guidelines contradict any particular regulatory requirements in the jurisdiction within which you operate? If so please provide a brief description of the conflicting provision and a reference to the relevant law or regulation.

- 2 The Board considered whether a distinction should be made between a fairness opinion, contained in a comprehensive and detailed report delivered to the commissioning party (sometimes known as the "Board Book" or "Board Presentation"), and any abbreviated document that is publicly disclosed. It agreed that while it is common practice to prepare a summary of the conclusions reached by the opinion provider for publication or circulation to all stakeholders, a clear line does not exist between the different formats used for reporting, and they are part of the same service.

Do you agree with this conclusion? If not, what distinctions do you believe should be made in the Guidelines between the content of an opinion intended for the commissioning party and one intended for public disclosure?

- 3 Paragraphs 3 & 4 of the Exposure Draft describe what a fairness opinion is and also what it is not.
- a) Is this description consistent with fairness opinions delivered in those jurisdictions within which you operate?
 - b) Do you consider it helpful for users and in the wider public interest for the IVSC Guidelines to attempt to define the nature of a fairness opinion?

- 4 The Board has tentatively decided that the Guidelines should be confined to the process of establishing independence and objectivity, matters that should be addressed in determining the scope of work, the conditions applicable to the assignment and the matters to be included in a typical fairness opinion. It considered that extending the guidance into matters that might indicate whether a proposed transaction was fair or not, e.g. the nature, extent and timing of a proposed transaction, would be impractical in an international context and could be interpreted as constraining a fairness opinion provider's judgement in certain cases.

Do you agree with the Board's decision to exclude guidance on criteria to be considered in determining whether a proposed transaction can be determined Fair or not? If you disagree, please indicate the types of additional guidance that you believe could usefully be included.

- 5 The Board considers it vital that the provider of a fairness opinion is sufficiently independent to provide, and be seen to provide, an Opinion that is objective and unbiased. These criteria apply to all valuation related services and the *Code of Ethical Principles for Professional Valuers* (the "Code") published by IVSC in 2011 includes discussion and guidance on how professional valuers can identify threats to their independence, and actions that may be taken to avoid or mitigate such threats. Paragraphs 10-18 of these Guidelines supplement the Code by providing some specific examples of threats to a fairness opinion provider's independence.

Do you consider that the Guidelines, when read in conjunction with the Code, adequately cover the threats to independence and objectivity that are likely to arise when considering whether an individual or firm should accept an appointment to provide a fairness opinion? If not please indicate either the additional threats that you believe should be identified or any threats that are identified in the draft that you believe should be modified or excluded.

- 6 IVS 101 *Scope of Work* lists matters that should be addressed in agreeing the scope and terms of any valuation assignment. These are applicable to valuation advice contained within a fairness opinion. Paragraphs 19-21 of the draft Guidelines set out some specific matters additional to those in the IVS that should be considered when agreeing the scope and terms for providing a fairness opinion.

Do you consider that the Guidelines, when read in conjunction with IVS 101, adequately identify the principal matters that should be considered in agreeing the scope of work and terms for the provision of a fairness opinion? Please identify any additional matters that you consider should be included.

- 7** Where a fairness opinion includes a valuation, the principles of IVS 103 Reporting are applicable. Paragraphs 28–32 of these Guidelines discuss the principles that should be considered in determining the content of a fairness opinion and then list matters that it is recommended should be included in a typical Opinion.

Do you consider that this list of recommended contents is a) helpful and b) sufficiently comprehensive? Are there any matters that you believe should be excluded, or additional matters included?

- 8** Paragraph 31 r) includes some recommended restrictions and limitations for inclusion in a fairness opinion.

Do you consider that these restrictions and limitations are a) reasonable and b) applicable in the jurisdiction in which you operate? Are there any additional restrictions and limitations that you believe could usefully be added to those recommended?

- 9** The Guidelines are intended to be helpful to those who commission fairness opinions, those who provide them and those who rely on them.

Are there any additional matters that you believe should be addressed in the guidance in order to best meet this objective?

EXPOSURE DRAFT

Procedural Guidelines for Fairness Opinions

Preamble

The International Valuation Standards Council (IVSC) is an independent, not-for-profit, private sector organisation that has a remit to serve the public interest. The IVSC's objective is to build confidence and public trust in the valuation process by creating a framework for the delivery of credible valuation opinions by suitably trained valuation professionals acting in an ethical manner.

The IVSC achieves this objective by:

- creating and maintaining the International Valuation Standards (IVSs);
- issuing technical guidance for professional valuers; and
- promoting the development of the valuation profession and ethical practices globally.

Fairness opinions are typically commissioned by fiduciaries to assist in demonstrating their application of business judgement and exercise of duty of care related to a potentially important transaction or use of an organisation's resources. Many fairness opinions are based on valuation analyses. The IVSC is of the view that it is in the public interest to promote understanding of the purpose of a fairness opinion, and to identify principles of best practice in the development and provision of fairness opinions.

The IVSC recognises that in some countries, national securities regulators have rules governing when fairness opinions are required, who should commission them, who should provide them and what they should contain. These Procedural Guidelines are intended for use where no such regulations exist or where regulations are silent on matters covered by these Guidelines.

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IVSC Procedural Guidelines for Fairness Opinions

Introduction

- 1 These Procedural Guidelines (the “Guidelines”) describe the nature of fairness opinions (FOs) and provide guidance on procedures for their provision.
- 2 A fairness opinion (FO) helps fiduciaries¹ to fulfil their responsibilities to consider whether a contemplated transaction is in the interests, from a financial point of view, to those to whom a duty of care is owed.

What is a Fairness Opinion?

- 3 A FO is a communication from a FO provider to the commissioning party that contains the FO provider’s opinion as to the fairness, from a financial point of view, of the consideration to be received or paid in a contemplated transaction. The work related to the provision of a FO considers the specified terms of a contemplated transaction regarding the consideration to be received or paid, and includes a comparison of the value of the interests given up to the value of the interests received.
- 4 A FO is not:
 - a. an opinion or any form of assurance that the highest and best possible price is being obtained or received for a given transaction;
 - b. an assessment or evaluation of the sale or negotiation process leading to the pending transaction or consideration to be paid/received therein;
 - c. an affirmation of the strategic merit of the contemplated transaction;
 - d. a recommendation to security holders on how to vote;
 - e. an analysis of, or opinion on, other aspects of a given transaction such as lockups, termination fees, severance agreements, and so on;
 - f. a confirmation of, or any form of opinion or assurance (audit, review, or compilation) on, historic or, prospective financial or any other information provided by or on behalf of the client or obtained publicly.

However, one or more of these factors, if relevant, may be considered in arriving at an opinion as to the Fairness, from a financial point of view, of the consideration being analysed by the FO provider under a contemplated transaction.

¹ Such as Corporate Directors, Trustees or Fund Managers, where such individuals have undertaken to act for and on behalf of others and which give rise to a relationship of trust and confidence.

When is a Fairness Opinion Required?

- 5 Examples of transactions for which fiduciaries would commission a FO include, but are not limited to, the following:
- takeover bids;
 - compulsory acquisitions and buy-outs of minority security holders;
 - plans or schemes of arrangement;
 - capital reorganisations, including recapitalisation transactions and debt-for-equity swaps;
 - going-private transactions;
 - related party transactions;
 - transactions with persons in positions of influence;
 - buy-backs; and
 - tender offers, sale or merger transactions not involving an auction.

Purpose of a FO

- 6 FOs can assist fiduciaries in demonstrating their application of business judgement and duty of care relating to a potentially important transaction or the use of an organisation's resources. Fiduciary duties are ever-changing and are based on the continued guidance of law, courts, regulations, and regulators.
- 7 A primary duty underpinning a fiduciary's approval of a contemplated transaction or of the consideration under a contemplated transaction, as appropriate, is the duty of care. It has been determined in some courts that a fiduciary demonstrates a duty of care when the fiduciary acts in a diligent and reasonable fashion after due consideration of relevant facts, adequate information, and appropriate deliberation in arriving at a decision that involves the organisation.
- 8 Some courts have held that the application of business judgement protects a fiduciary from "after-the-fact" challenges regarding the manner in which the fiduciary conducted his or her activities in the contemplation of a proposed transaction. As a result, unless it is apparent that a fiduciary violated reasonable expectations of conduct, courts or regulators are less likely to review or question the fiduciary's activities and decisions or rule in such a fashion if required to review such activities.
- 9 A FO typically opines on the fairness, from a financial point of view, of the consideration under a contemplated transaction, to any one of a range of stakeholders, all of the security holders or a certain group of security holders. The circumstances of the contemplated transaction and, if applicable, the relevance of any securities legislation or legal precedent may help define the stakeholder(s) to whom the fairness of the consideration under the contemplated transaction should be evaluated.

Ethical Considerations

- 10** The IVSC *Code of Ethical Principles for Professional Valuers* (the "Code") identifies five Fundamental Principles of ethical conduct that can be applied to the provision of FOs. The Code also includes guidance on the application of the principles, discussion of possible threats to compliance and actions that a professional valuer can take to avoid or mitigate those threats. It is recommended that the Code is followed when applying these Guidelines.
- 11** The five Fundamental Principles identified and discussed in the Code are Integrity, Objectivity, Competence, Confidentiality, and Professional Behaviour. These Guidelines describe particular threats to an FO provider's integrity and objectivity that may arise in the course of an FO assignment.
- 12** It is important that a FO is objective and unbiased and should not be perceived as supporting the views of any interested party, including the commissioning party. A FO provider therefore needs to take all steps necessary to avoid threats to their independence. In particular, a FO provider should not accept an assignment where the commissioning party, or any other stakeholder in the transaction, seeks to unreasonably limit the investigations to be undertaken or to direct or otherwise influence the methods adopted or the conclusions reached.
- 13** Before accepting an assignment to prepare an FO, the FO provider should consider any existing or proposed relationships that they or their firm or organisation have that may impair, or create the appearance of impairing, their independence and evaluate the extent of that impairment. Examples include:
- relationships with the commissioning party, including its non-independent directors, management, controlling security holder(s), other stakeholders; or
 - any relationship that creates, or may reasonably be perceived as creating, the FO provider with an interest in the outcome of a contemplated transaction.
- 14** The closer the relationship between the FO provider, including the FO provider's family, associates and staff, and a commissioning party or any other interested party, the greater the onus on the FO provider to demonstrate their impartiality.

15 Beyond relationships between the FO provider and other parties involved in the proposed transaction, there are also other interactions or events that could create an actual or perceived threat to a prospective FO provider's ability to comply with the Fundamental Principles in the Code. The following are examples of typical interactions or events:

- The FO provider becomes aware that either:
 - i* the commissioning party rejected another FO provider after that FO provider disclosed the likely approach to evaluate the fairness of the consideration under a contemplated transaction; or
 - ii* another FO provider declined to provide an opinion after being engaged;
- a FO provider, in an existing or prior assignment, gives advice on strategy, or attends discussions whereby the strategy and merits of the contemplated transaction are being developed;
- any act that could give rise to the perception that the FO provider is taking instruction from the commissioning party or other interested parties on the approach, valuation methods to be used or the conclusions to be reached;
- the FO provider accepts data and analysis from the commissioning party or other interested parties without critical review;
- the FO provider enters a fee agreement where the fee or the fee amount is dependent upon either the outcome of the transaction or the FO provided;
- the FO provider discusses future business relationships with the commissioning party or any other interested party before issuing the final FO;
- the FO provider changes their FO following a factual review of a draft of the FO by the commissioning party for a reason other than a change in the facts on which it was based;
- the FO provider changes its opinion at the suggestion of the commissioning party or any other interested party without due inquiry and analysis by the FO provider.

16 When a FO provider identifies a potential threat to their ability to comply with the Fundamental Principles they should evaluate the significance of that threat. Some threats may be eliminated or reduced to an acceptable level by taking appropriate safeguards. However, as provided in the Code, if the threat or threats to the FO provider's ability to comply with the Fundamental Principles cannot be eliminated, or reduced to an acceptable level, the assignment should be declined or discontinued.

17 The types of safeguards that can be used to eliminate or significantly mitigate threats to integrity or objectivity are discussed in the Code. Measures that can effectively manage potential conflicts with the Fundamental Principles when preparing a FO include limiting the dissemination of information within the FO provider's firm (including affiliates or entities of the FO provider's firm), and between the FO provider's personnel with access to the information and colleagues who might represent or be perceived by a reasonable person to have conflicting interests.

18 The nature of any relationship or involvement that creates the potential threat and the action taken to avoid or mitigate it should be referred to in the scope of work and disclosed in the FO.

Scope of work

- 19** In the likely situation that a FO includes valuation analyses, a valuation or a range of values the IVSs can be applied to the assignment. IVS 101 *Scope of Work* contains requirements for matters to be considered and recorded in writing between the FO provider and the commissioning party before a valuation is provided.
- 20** To comply with IVS 101 the scope of work should be agreed and recorded in an engagement letter signed by the FO provider. It is also good practice for this to be signed by the commissioning party.
- 21** In addition to the matters identified in IVS 101 *Scope of Work*, the following matters should be given specific consideration in developing a scope of work for the provision of an FO:
- a the appropriate approaches, methods, and techniques to be employed in analysing the proposed transaction and developing the FO,
 - b the reasonableness and appropriateness of assumptions used in the analysis which, if changed, might have a material impact on the opinion,
 - c whether the FO provider will give the commissioning party a draft of the FO for a factual review before finalisation and any appropriate conditions to avoid any perception of inappropriate influence on the conclusion (see para 16),
 - d the extent of investigation and verification that is appropriate and
 - e the extent to which specialist assistance may be required.

The final two points are examined further in the following paragraphs.

Extent of investigations

- 22** The FO provider's responsibility to assemble and verify data, or conversely the extent to which data provided by third parties, including the commissioning party, is to be used should be recorded in the scope of work.
- 23** The information required to be produced by or on behalf of the commissioning party in support of the FO analysis should be determined by the FO provider and if this information is not given in a satisfactory format, consideration should be given to terminating the assignment or refusing to issue the FO.
- 24** It is common for a FO provider to exclude responsibility for independently verifying some of the data relied upon in developing the FO and instead to rely on information supplied by the commissioning party or an unconnected third party. However, the FO provider should exercise reasonable professional scepticism in using information provided by others and request additional information or further clarification if the information provided is considered to be in any way inadequate or unusual. The more material the information is to the conclusions reached by the FO provider, the greater the responsibility of the FO provider to examine the information. If there are indications suggesting that the information in question may not be reasonably relied upon, the FO provider should consider terminating the assignment or refusing to issue the FO.

- 25** The extent to which the FO provider has relied upon information provided by the commissioning party or third parties should be disclosed in the FO but if the FO provider considers that there are any material deficiencies in the information provided an FO should not be issued.
- 26** If a FO provider does not have the necessary expertise to critically review information that is material to the overall opinion, the commissioning party or the FO provider should retain an appropriate specialist who is also independent of the commissioning party. Such a specialist should report to the FO provider and not to the commissioning party.
- 27** If it is necessary for the FO provider to rely on the work of other specialists, the FO provider should investigate the specialists' reputation, perceived competence and independence from the proposed transaction and the parties involved with it. The reasonableness of the assumptions and methods used by the other specialists are their responsibility. However, the FO provider should ensure that they have sufficient understanding of the work or advice received from a specialist before relying upon it and, if not satisfied that this work or the advice is reasonable, should request the specialist to provide additional information or justification.

Content of a Fairness Opinion

28. This section gives guidance on the typical contents of a FO. It is not intended to be either a comprehensive list containing every item that may need to be referenced in a FO for every type of situation or to impose requirements that may not be relevant for some types of assignments. The regulatory regime under which the FO is to be provided may also stipulate that specific matters be addressed.

- 29** The format, subjects included and the amount of information provided are matters that require professional judgement. Factors to be considered in exercising this judgement include:
- the nature and complexity of the subject of the opinion and
 - the extent of the intended users' knowledge of the facts on which the FO is based.
- 30** The overriding principle that should guide the exercise of the FO provider's judgement is that the FO should provide sufficient information to enable the reader to reasonably understand the factual background, the principal judgements made and the rationale used in arriving at the conclusions it contains. The anticipated format and level of detail in the FO should have been addressed and recorded in the scope of work, see IVS 101 Scope of Work 2(l).
- 31** Where an FO contains a valuation, a range of values or an analysis of any valuation, the IVSs are applicable to the assignment. In particular, the requirements of IVS 103 *Reporting* are relevant to the FO deliverable. If the FO contains a valuation provided by another specialist, it is recommended that the FO provider ensures that the specialist's assignment and report are in accordance with the IVSs and that an appropriate reference to this report is agreed with the specialist and included in the FO.

32 Subject to the foregoing, the following is a list of matters that are recommended to be included in most FOs. These are in no particular order:

Engagement background

- a The identity of the FO provider.
- b The purpose of the FO.
- c The definition of the term “fairness” and the criteria used to provide an opinion.
- d The effective date of the FO.
- e By whom the FO provider was engaged and to whom the FO is being addressed, if different.

Independence

- f A statement as to whether the FO provider has knowledge of any material relationships with the client, management, or other interested parties that might reasonably give rise to a perception that the FO provider’s independence is compromised, (see paras 16 and 19 above).
- g The following details of the fee paid to the FO provider for the assignment:
 - i a statement as to whether the fee is contingent on an action or event resulting from the use of or relating to the FO; or
 - ii the nature of any consideration that is contingent on either the outcome of the contemplated transaction or the opinion provided (see para 16).

Transaction background

- h A description of the contemplated transaction and/or the consideration under a contemplated transaction, as appropriate, including the context of the transaction.
- i A description of the consideration being offered to the security holder (or to a group of security holders).

Scope of analysis

- j* A description of the relevant business, assets, or securities.
- k* Relevant case precedent, securities legislation, regulations or policies followed in preparing the FO.
- l* A description of the scope of work, including a summary of the information reviewed and relied upon. Where the FO provider was limited in the scope of review or where information provided to the FO provider was substantially incomplete, disclosure shall be made of the limitation(s) and of the incomplete information, reasons given, and the potential impact of such limitation(s) on the FO conclusions.
- m* A discussion of any relevant offers, prior valuations, or expert reports considered by the FO provider in arriving at the FO conclusion. The FO Provider should be careful not to disclose or directly refer to information on which they may have relied in reaching their opinion if it is confidential, legally privileged or commercially sensitive.
- n* A description of the valuation approaches and methods used and the reasons for selecting them.
- o* The basis of value used and its definition (see *IVS Framework*) and any additional assumptions (eg whether valued assuming a going concern or assuming liquidation).
- p* The assumptions relied upon in arriving at the FO conclusion(s). If material, the sensitivity of the FO to the assumption should be stated.
- q* A conclusion as to the fairness of the consideration under the contemplated transaction from a financial point of view, as appropriate to the relevant stakeholders.

Restrictions and limitations

- r* Any restrictions or limitations on the use of the FO, or on the FO Provider's liability, e.g.:
 - i* any qualification(s) or limitation(s) to which the FO is subject;
 - ii* a statement restricting the use of the FO to the party for whom it was prepared and only for the stated purpose;
 - iii* a statement disclaiming responsibility for losses resulting from unauthorised or improper use of the FO.