

19 June 2012

Mr. Chris Thorne  
Chairman  
International Valuation Standards Council  
41 Moorgate  
LONDON EC2R 6PP  
United Kingdom

**Exposure Draft, "Procedural Guidelines for Fairness Opinions"**

Dear Sir:

We appreciate the opportunity to comment to the International Valuation Standards Council's ("IVSC" or the "Board") on the Exposure Draft, "Procedural Guidelines for Fairness Opinions" (the "ED").

We applaud the IVSC's efforts to develop a common set of procedural guidelines (the "Guidelines") for fairness opinion ("FO") providers and users.

We believe that a set of procedural guidelines surrounding the issuance of fairness opinions will aid in the quality and reliability of fairness opinions. As such, the IVSC's efforts will help aid in this stated purpose.

Please refer to Questions 1 through 9 in Appendix A for our responses to the questions posed by the IVSC in the ED. We would be pleased to discuss our comments with members of the Board or the IVSC staff at your convenience.

Very truly yours,

*Ernst & Young LLP*

## Appendix A

### Question 1

The Board recognizes 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.*

#### **NASD Rule 2290 Regarding Fairness Opinions**

NASD Rule 2290 was issued on 8 December 2007 and outlines the disclosure requirements and procedures addressing conflicts of interest when issuing a FO that are required by the Financial Industry Regulatory Authority. The ED does not appear to directly conflict or contradict any of the requirements set forth by *NASD Rule 2290 Regarding Fairness Opinions* ("2290"). However, there are a number of disclosure requirements stipulated by 2290 that are either omitted by or not fully set forth by the ED.

#### **Disclosure of independent verification of information**

Paragraph 32 of the ED states that "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." In doing so, the ED states that FO providers "should exercise reasonable professional skepticism in using information provided by others." 2290 explicitly requires a firm disclose what information has been verified or "the categories of information that were verified." We note that there are no disclosure requirements stipulated by the ED in relation to the independent verification of data. In addition, we note that the terms "reasonable professional scepticism" and "verified" have not been defined. We recommend clearer direction or procedures to be performed in regards to verifying data or exercising reasonable professional skepticism.

#### **Disclosure of material relationships**

In paragraph 32(f) of the ED, it is suggested that a FO should disclose "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." Meanwhile, 2290 states that an FO provider must disclose "any material relationships that existed during the past two years or that are mutually understood to be contemplated in which any compensation was received or is intended to be received as a result of the relationship between the firm and any party to the transaction that is the subject of the fairness opinion." We note that 2290 explicitly specifies that past, present and contemplated material relationships should be disclosed

when issuing a FO while the ED may potentially be interpreted as stating that only current relationships should be disclosed. We note that the statement “might reasonably give rise to a perception that the FO provider’s independence is compromised” is ambiguous by nature and potentially allows a FO provider to exclude relationships that would require disclosure under 2290.

***Disclosure of contingent payment or compensation in connection with a transaction***

Paragraph 32(g) of the ED states that a FO must include the details surrounding the nature “of any consideration that is contingent on either the outcome of the contemplated transaction or the opinion provided.” This compares to 2290 which states that a FO provider “must disclose if it will receive any other significant payment or compensation contingent upon the successful completion of the transaction.” 2290 goes on to state that one of the reasons why the term “significant” is not defined is to prevent a requirement that the FO provider disclose “the receipt of de minimis fees (such as trading fees or other small incremental fees from account assets or activity).” Given that the ED calls for the disclosure of “any [contingent] consideration,” FO providers will be required to disclose a breadth of de minimis fees in order to be in compliance with the Guidelines. In addition, the ED does not explicitly define “compensation” leaving ambiguity surrounding what forms of non cash compensation must be disclosed. Given that many FO providers operate as part of large global organizations with a wide array of business lines, a comprehensive list of all contingent considerations resulting from a list may not only be burdensome but could be difficult to implement without potential confidentiality concerns.

***Disclosure of the use of a fairness committee***

2290 states that “A disclosure of whether or not the fairness opinion was approved or issued by a fairness committee is required... the term, ‘fairness committee’ includes any committee or group that approves a fairness opinion in accordance with the requirements of paragraph (b) regardless of whether the member firm calls it a ‘fairness committee.’” The ED does not mention any disclosure relating to the FO providers review process and quality control surrounding the issuance FOs. Disclosures relating to the nature of a FO provider’s review process are not only valuable information but also encourage higher levels of quality control.

***Disclosure of compensation to insiders***

Rule 2290 requires that FO providers disclose “whether or not the fairness opinion expresses an opinion about the fairness of the amount or nature of the compensation to any of the company’s officers, directors or employees, or class of such persons, relative to the compensation to the public shareholders of the company.” In certain instances, this disclosure will help investors accurately assess the independence of a FO.

**Question 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?*

We do not believe that it is common practice to prepare a comprehensive and detailed report by the opinion provider for publication or circulation to all stakeholders. Pursuant to this belief, we do not feel that the Board Book and its public disclosure should be required. We do feel that a comprehensive and detailed report by the FO provider should be disclosed to the commissioning party. However, it is our stance that the requirements for public disclosures should be determined by regulators.

In many instances FOs are issued to privately held corporations who do not require a summary of conclusions reached by the FO provider to be distributed to stakeholders. In other instances, FOs which are issued to public companies for transactions, that are not deemed to be material. In these cases, stakeholders do not receive a summary of the conclusions reached by the FO provider. In addition, we note that the term “all stakeholders” is open to various interpretations and should be determined by local regulators.

Each country may have its own common practices. For example it is not common practice in Australia to do a Board Book or Board Presentation.

Furthermore we note that the Exposure Draft refers to a FO as a ‘communication’ (paragraph 3) however it does not make a distinction as to whether it is to be issued in a public document or to the board of directors only (i.e. private opinion).

### **Question 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?*

The definition of a fairness opinion in the first sentence of paragraph 3 is broadly consistent with the definition of a FO in our jurisdiction.

We do, however, note that Paragraph 4(c) states that a FO is not “an affirmation of the strategic merit of the contemplated transaction.” Although we agree that a FO is not a direct affirmation of strategic merit of an acquisition, it should quantify the expected strategic benefits (i.e. from a financial point of view, consideration received or paid) of the transaction if it is part of the consideration needed or paid.

We do agree that it is helpful for users and in the wider public interest for the IVSC Guidelines to attempt to define the nature of a fairness opinion. However it is not clear from the Exposure Draft as to how and by whom the proposed guidelines would be regulated. In our experience in the absence of any regulatory oversight these types of guidelines will become meaningless. Guidelines that are reliant on self regulation will inevitably lead to interpretation differences which in practice may lead to a variety in the quality of FO’s, which in our view is contrary to the overall objectives of the guidelines.

#### Question 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.

Given that the nature of FO's can be driven by legislative/regulatory requirements that may differ in various jurisdictions it is potentially very difficult to include criteria to be considered in determining whether a proposed transaction can be determined fair or not.

We note that the Exposure Draft focuses on the financial aspects of a proposed transaction in regards to opining on the fairness of a transaction. In Australia, for example, an Independent Expert may opine that a transaction is not fair from a financial point of view but is still reasonable after consideration of a number of qualitative factors and that the advantages outweigh the disadvantages.

Factors to consider may include but is not limited to;

- a) The financial situation and solvency of the entity
- b) Opportunity costs
- c) The alternative options available to the entity and the likelihood of those options occurring
- d) The entity's bargaining position
- e) Whether there is selective treatment of any security holder, particularly a related party
- f) Any special value of the transaction to the purchaser
- g) The liquidity of the market in the entity's securities

While we note that the Board has decided to exclude guidance on criteria to be considered in determining whether a proposed transaction can be determined Fair or not, it may be useful for preparers of FO's to understand that while a transaction may not be fair from a financial perspective it could still be reasonable after considering other qualitative factors.

#### Question 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.

### ***Comparison to The Code***

We note that Section 3.2.13 of the Code states “A Professional Valuer’s objectivity may be threatened by a broad range of circumstances, for example, self-interest threats, advocacy threats, familiarity threats, self-review threats, and intimidation threats. Safeguards may eliminate or reduce such threats, and may be created by external structures (e.g. the valuer’s professional body, legislation or regulation), or by the valuer’s work environment (e.g. quality control policies and procedures). There may also be safeguards specific to the valuation engagement.” The ED, in its current state, does not set forth any guidelines for quality control policies and procedures. We feel that proper quality control guidelines are important to ensure that proper ethical standards are uniformly met across all FOs and should be included in the Guidelines. More specifically, we feel that guidelines mandating reviews by a “fairness committee” that includes qualified professionals who are not part of the “deal team” as defined in 2290 would greatly assist in ensuring that sections 3.3.1, 3.2.3, and 3.2.9 of the Code are upheld.

Section 3.5.8. of the Code states that “A Professional Valuer must make diligent enquiries and investigations to ensure that the data for analysis in the valuation can be relied upon.” Paragraph 32 of the ED states that FO providers “should exercise reasonable professional skepticism in using information provided by others.” The term “reasonable professional skepticism” is not defined, and, as such, may not encompass the level of enquiries or investigations required by The Code.

### ***Strategic advice***

Paragraph 15 of the ED states that a FO provider’s independence is compromised if “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.” It is unclear as to how the provider’s attendance in strategic discussions or disbursement of strategic advice causes conflict of interest, or undue influence or bias to override professional or business judgment. As such, we recommend that this should be deleted.

### ***Critical review***

In Paragraph 15 of the ED an occasion where a FO provider “accepts data and analysis from the commissioning party or other interested parties without critical review.” The term “critical review” is not defined and could be subject to differing interpretations. In particular, the term review could be interpreted under the American Institute of Certified Public Accountants’ definition: “performing inquiry and analytical procedures that provide the accountant with a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the financial statements for them to be in conformity with GAAP or, if applicable, with OCBOA.” We believe that this is not in the interest of the committee and should be modified.

### ***Future business relationships***

Paragraph 15 of the ED notes that FO providers may compromise their independence if they “discusses future business relationships with the commissioning party or any other interested party before issuing the final FO.” We note that many providers issue a FO while simultaneously carrying out an array of services related, or unrelated, to the transaction. These services could include or could not include those which restrict a firm from discussing future relationships while performing a FO will not only be extremely difficult to implement but could potentially be detrimental to execution of the transaction in question. We feel that this section of the paragraph should be excluded.

#### **Question 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.

Based on our response to Question 2, we do not feel that the Guidelines fully comply with IVS 101. Given that the deliverables required by FO providers vary greatly by the nature of facts and circumstances surrounding the FO, the Guidelines should require that the scope includes a description of the final deliverable(s) in order to be in compliance with Paragraph 2(l) of IVS 101.

We note that, IVS 101 does not cover the full scope of work required by a FO. In addition to the proposed Guidelines and IVS 101, a FO provider should also ensure that an agreement is made with the client regarding how the fairness of a transaction, from a financial point of view, is to be determined when developing the scope of work.

In certain circumstances, we note in relation to the use of specialists in Australian, for example, if an expert does not have the necessary specialist expertise on a matter that must be determined it is mandatory for an expert to involve a specialist RG112.67 to 112.77.

We note that the ED states (paragraph 26) that if a FO provider does not have the necessary expertise to critically review information that is material to the overall opinion the FO should retain a specialist.

#### **Question 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?

Yes it is helpful and is sufficiently comprehensive. It may also be useful to include in the list of information, sources of information and a glossary of terms.

Other matters to include that may be useful to a reader of a FO may include the following:

- a) Industry overview and outlook
- b) Overview of the business including historical financial performance and financial position of the business as at the valuation date.

#### **Question 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?

No comment.

#### **Question 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?

#### ***Review and Quality Control Guidelines***

In order to meet the IVSC's stated objective to "build confidence and public trust in the valuation process by creating a framework for the delivery of credible valuation opinions," a level of consistency in the quality of FOs both within and across organizations must be achieved. We note that the ED does not include any procedural guidelines surrounding review and quality control procedures in relation to FOs. We suggest that the IVSC recommend the usage of a review process utilizing similar to the "Fairness Committee" stipulated by 2290. In doing so, we recommend that the Guidelines suggest that a FO provider assemble a panel of independent qualified professionals to review the FO prior to issuance. In addition, we suggest that the Guidelines require that FO

provider disclose the (a) process by which the fairness committee was selected (b) the qualifications of the members of the fairness committee and (c) the independence of the members of the review committee

### ***Reasonable Professional Skepticism***

As stated before, Paragraph 32 of the ED states that FO providers “should exercise reasonable professional skepticism in using information provided by others.” We note that the term “reasonable professional skepticism” has not been defined. The amount of required diligence surrounding the use of information provided by others remains somewhat ambiguous. We suggest that the term should be defined with references to previously accepted legal terms.

### ***Duty of Care***

In Paragraphs 2, 6 and 7 the ED uses the term “duty of care.” We note that the term appears to be used under the definition applied to it by United States Delaware Case Law and the Model Business Corporation Act issued by the American Bar Association. This term may be subject to different interpretations in different jurisdictions and legal codes (e.g. English Tort Law). We recommend that the term “duty of care” should either be defined by the Board or omitted from the Guidelines.

### ***Paragraph 5 Heading***

We suggest that the heading to paragraph 5 reading “When is a Fairness Opinion Required?” can be interpreted as the IVSC attempting to require corporations to receive a FO under certain circumstances. This appears to overstep the scope and intended purpose of the Guidelines. We suggest that the heading should read “When Should a Fairness Opinion be Recommended.”

### ***Regulation***

As discussed earlier, from a practical point of view, consideration needs to be given as to how these guidelines will be regulated in order to ensure consistency of interpretation and consequently meaningful FO’s.