MERCER CAPITAL
MERCER CAPITAL'S
Value Matters™

Volume 2008-03 » March 25, 2008
www.mercercapital.com
mcm@mercercapital.com

FINRA Rule 2290 Aims to Increase Transparency of Fairness Opinions

On October 11, 2007 the SEC approved FINRA's new Rule 2290 regarding the preparation of fairness opinions and the disclosures required in fairness opinions.[1] The rule, which began to take form in 2004 and was opened for comments in early 2006, was fast tracked for approval by the SEC. While Rule 2290 is officially applicable only to member firms of FINRA, it is likely to become a market standard by which all fairness opinions are evaluated.

The purpose of the new rule is to address increasing concerns that disclosures provided in fairness opinions may not sufficiently inform shareholders of potential conflicts of interest that may exist among the parties to a deal, those advising on the deal, and those opining to the fairness of the deal. Unfortunately, avoiding the appearance of a conflict is not quite the same as avoiding a conflict. While the new rule provides for added transparency, it does not eliminate potential conflicts of interest.

The portion of the new rule related to disclosures [2290(a)] is applicable if the FINRA member issuing the opinion "knows or has reason to know that the fairness opinion will be provided or described to the company's public shareholders" and covers the following general topics:

1. *Contingent Compensation*. Section 2290(a)(1) of the rule requires that the firm issuing the fairness opinion must disclose any contingent compensation to be received upon successful completion of the transaction. This includes contingent compensation received for rendering the fairness opinion, serving as an advisor or for any other reason so long as payment is contingent on closing the deal. It is common for a firm to be compensated with fees contingent upon the completion of the deal when acting in an advisory role. However, a contingent payment structure for an opinion that is intended to be strictly informative in nature only serves to create biases where there should be none.

   Public shareholders would be better served if instead of simply requiring disclosure, firms were forbidden to perform fairness opinions if they are to receive any fees contingent upon the deal. This would eliminate the ability of firms who hold an advisory role in the deal to also perform the fairness opinion – a clear conflict of interest. It is also noteworthy that the rule does not require the disclosure of the amount of the contingent fee to be received. Surely a firm receiving a $1 million contingent fee would be cause for more concern than a $50 thousand contingent fee.

INSIDE

1 FINRA stands for the Financial Industry Regulatory Authority. This organization was formed in July 2007 through the consolidation of the National Association of Securities Dealers (NASD) and the regulation, enforcement and arbitration functions of the New York Stock Exchange.

2. *Preceding Relationships*. Section 2290(a)(3) is meant to provide shareholders with information regarding any existing relationships between the firm providing the fairness opinion and any party to the transaction to which the fairness opinion applies. The types of relationships that must be disclosed are those that have existed in the past two years (either explicit or mutually understood among the parties) for which any compensation has been or will be received as a result of the relationship.

   There were concerns over the fact that this rule may cause an issuing firm to breach confidentiality or otherwise disclose private information of clients. FINRA offered guidance to suggest that the disclosure of a relationship need only be descriptive (as opposed to quantitative in nature). Thus, clients should feel confident hiring a firm with which they have former experience without worrying that sensitive information could be divulged.

3. *Independent Verification of Information*. Section 2290(a)(4) requires that a firm disclose whether or not underlying information was independently verified. The rule is clear that a lack of independent verification does not necessarily imply a conflict or diminish the reliability of the opinion. It is uncommon for a firm issuing a fairness opinion to independently verify much, if any, of the information that is provided by management of the companies which are parties to the deal.

4. *Approval by a Fairness Committee*. Section 2290(a)(5) requires the issuing firm to disclose whether or not the opinion was approved by a committee. As opposed to independent verification of information, failure to submit the fairness opinion for the approval of a committee, particularly in the instance of complicated or controversial transactions, can be cause for alarm on the part of a shareholder. The new rule provides further guidance concerning committee review in the section regarding procedures.

5. *Fairness of Compensation*. Section 2290(a)(6) requires an issuing firm to disclose whether an opinion is expressed regarding the fairness of compensation to officers, directors, and other personnel, although the validity of the opinion is not necessarily affected one way or the other.

   It is rare that a fairness opinion involves the analysis of the fairness of compensation that will be paid as a result of the transaction to the officers, directors, or other personnel of either the buyer or the seller. One reason is that issuing firms are rarely experts in compensation. Additionally, a fairness opinion opines to the fairness of the amount to be received by shareholders according to how the deal is constructed. That amount is either fair or unfair, and any number of factors (one of which could be compensation) can cause the deal to be unfair to shareholders.

The new rule also contains a section [2290(b)] that delineates certain written procedures an issuing firm must develop (and of course follow) in the preparation of a fairness opinion. The majority of these procedures relate to the use of a fairness committee.

1. The issuing firm must develop written procedures for determining the circumstances under which a fairness committee must approve a fairness opinion. When a committee is deemed to be appropriate, the firm must also have developed and followed procedures concerning the following:

   a) The issuing firm must have a written procedure which is used to select the personnel that comprise the fairness committee.

   b) Those procedures must specify the qualifications required for persons to sit on the fairness committee.

RECENT FAIRNESS OPINIONS

Wunderlich Investment Company, Inc.

Memphis, Tennessee

Fairness opinion on behalf of Wunderlich Investment Company, Inc. in the sale of an interest to Coil Investement Group

MERCER CAPITAL

Ohio County Bancshares, Inc.

Beaver Dam, Kentucky

Fairness opinion on behalf of Ohio County Bancshares in its acquisition by Porter Bancorp, Inc.

MERCER CAPITAL

E.C. Barton & Company

Jonesboro, Arkansas

Fairness opinion on behalf of the Company's ESOP in the acquisition of Grossman's Bargain Outlet

MERCER CAPITAL

c) The process must promote a balanced review of the opinion, and the review should involve personnel who are not on the deal team to the transaction. If the firm issuing the opinion is not involved in the transaction as an advisor, then it follows that those persons reviewing, as well as working on, the fairness opinion will not be on the deal team.

2. The issuing firm must also create procedures with which to evaluate the appropriateness of the valuation analyses used in the fairness opinion. The addition of this rule demonstrates that FINRA recognizes the importance of valuation technique in rendering a fairness opinion.

While the new rule provides for added transparency, it does not eliminate potential conflicts of interest.

Several conclusions can be drawn from the new FINRA rule. First, FINRA is clearly attempting to provide shareholders with more information and allow them to make their own decisions regarding the existence of conflicts. However, it appears to still be the responsibility of various parties to the transaction and their advisors to ensure that no conflicts exist, or at the very least, are minimized. Despite the new disclosure rules, any time the advisor on a deal prepares the fairness opinion or any time compensation for preparation of the fairness opinion is on a contingent basis, there exists the possibility for real or perceived conflicts of interest.

Further, FINRA pays significant attention to "quality control" issues within the issuing firm. While some of these issues would be rendered moot if FINRA would simply disallow firms with potentially large conflicts of interest from preparing the fairness opinion, the focus does indeed center on what is in the best interest of the shareholder.

Mercer Capital is well equipped to deal with the new FINRA rule for a number of reasons. We do not perform fairness opinions for a contingent fee and in instances where we act as an advisor on a deal, we will not perform the fairness opinion ourselves. In addition, Mercer Capital is very familiar with the concept of "committee review," having used committees to tackle complex valuation problems for years. It is almost certain that a fairness committee at Mercer Capital would have at least one member with a respected industry credential (CFA, ASA, CPA/ABV, etc.) and possibly several members. Mercer Capital's experience as an independent business valuation firm means that a client can be certain that any valuation analysis developed in the preparation of a fairness opinion will be both appropriate and objective.

Laura J. Hoffmeister
Laura J. Hoffmeister
hoffmeisterl@mercercapital.com

Nicholas J. Heinz
Nicholas J. Heinz
heinzn@mercercapital.com

MERCER CAPITAL'S E-BOOK LIBRARY

TITLE	DESCRIPTION	INVESTMENT	RELEASE DATE
UPDATED **The QMDM Companion, Version 4.0 (2008)**	The Quantitative Marketability Discount Model (QMDM) presents a practical model to assist business appraisers in developing, quantifying and defending marketability discounts under the income approach. The very latest version of the QMDM now includes a revised and expanded explanatory manual. The model and manual are delivered as a .zip file electronically via email.	**$125.00**	*Currently Available*
Valuing Financial Institutions	We are responding to requests to put this 1992 book back into print and we are doing so as an E-Book	**$65.00**	*Currently Available*
Are S Corporations Worth More Than C Corporations?	An e-booklet that adds to the S Corp vs. C Corp debate.	**$19.95**	*Currently Available*
Embedded Capital Gains	A closer look at the Embedded Capital Gains issue.	**$19.95**	*Currently Available*
Rate & Flow: An Alternative Approach to Determining Active/Passive Appreciation in Marital Dissolutions	In this e-book, we present an alternative model for determining active / passive appreciation in a marital dissolution.	**Complimentary**	*Currently Available*
QMDM Fact Sheet	The latest information about the QMDM in a pdf format	**Complimentary**	*Currently Available*

Visit our website at www.mercercapital.com for more information or to download an e-book.

NEW WHITEPAPER SERIES: "UNDERSTAND THE VALUE OF ..."

TITLE	DESCRIPTION	INVESTMENT	RELEASE DATE
NEW **Understand the Value of Your Electrical Distributorship**	Electrical equipment wholesalers operate in a highly fragmented industry, consisting largely of family-owned business with a few locations within a relatively close proximity. This article provides insight into the situational (when and why) and analytical (how) aspects of valuing electrical distributors.	**Complimentary**	*Currently Available*
NEW **Understand the Value of Your Start-Up Business**	Valuation for start-up enterprises can be a tricky proposition. Regardless of industry, start-ups generally share a common set of operational characteristics and valuation needs that are distinct from mature firms. This article discusses specific valuation considerations relevant to start-up companies.	**Complimentary**	*Currently Available*
Understand the Value of Your Independent Trust Company	Due to their variance in size, there is no one-size-fits-all definition of an independent trust company, and recognition of the particular attributes of independent trust companies is significant to understanding their value.	**Complimentary**	*Currently Available*
Understand the Value of Your Truck Dealership	Contrary to popular belief, not all truck dealers are worth book value. This article provides useful information as to how truck dealers are valued and what impact that might have on their owners.	**Complimentary**	*Currently Available*
Understand the Value of Your Brick Business	This article provides an informative overview regarding the valuation of businesses operating in the brick industry, including a discussion of value as it relates generally to both manufacturers and wholesalers, as understanding how brick businesses are valued may help you understand how to grow the value of your business.	**Complimentary**	*Currently Available*
Understand the Value of Your Insurance Brokerage	For the past several years, insurance brokerages have been in a period of consolidation, and the current soft market is expected to persist for at least the near term. As such, it is an opportune time for business owners to have an idea of what their brokerage business is worth.	**Complimentary**	*Currently Available*
Understand the Value of Your Physician Practice	The event that triggers ownership transfer can be categorized as either voluntary or involuntary. It is important for physicians to consider the universe of ownership transfer possibilities, because sooner or later, you will be involved.	**Complimentary**	*Currently Available*
Understand the Value of Your Auto Dealership	Because your dealership will change hands, it is important for you to understand the key concepts of business value and how value is determined for your dealership.	**Complimentary**	*Currently Available*
Understand the Value of Your Wholesale Distributorship of Malt Beverage Products	The financial landscape is littered with rules of thumb pertaining to the value of privately owned businesses. Perhaps in no other industry is the rule of thumb concept more prevalent than in beer distribution. It is critical that value be determined and articulated in a credible fashion.	**Complimentary**	*Currently Available*

Visit our website at www.mercercapital.com for more information or to download a whitepaper.

A GENTLE PLUG FOR OUR FIRM

MERCER CAPITAL is a business valuation and investment banking firm serving a national and international clientele. Our reputation for excellence is based on an ability to solve complex financial problems expeditiously. We convert over 20 years of experience, including thousands of assignments, into solutions for the issues of today.

Corporate Valuation. Mercer Capital provides a broad range of independent valuation and financial advisory services, including:

- » Dispute Analysis Services and Expert Testimony
- » Valuation for Corporate Tax Matters
- » Valuation for Corporate Income Tax Issues
- » Valuation for ESOPs
- » Purchase Price Allocations
- » Valuation of Employee Options
- » Goodwill Impairment Testing
- » Valuation of Intangible Assets
- » Fairness Opinions

Mercer Capital's investment banking professionals specialize in providing merger and acquisition services to sellers or buyers of private businesses or public companies divesting divisions and subsidiaries. In addition, we assist clients in industry consolidations, roll ups, and refinancings.

INTERNET COMMERCE: OBTAIN PROPOSALS TO VALUE YOUR COMPANY, BANK, FLP OR LLC VIA OUR WEBSITE

The cost of your time and delays in obtaining proposals has just gone down. Use one of the PROPOSAL REQUEST FORMS on our website.

Many of your colleagues have already used our PROPOSAL REQUEST FORMS and are impressed by the decrease in transactional overhead and the increased ease in obtaining actionable proposals for their clients. We are pleased to be doing business with them. Try it yourself! Visit our website and provide us with the pertinent information via this form, and we'll prepare a proposal and deliver it to you via e-mail, fax or USPS. Complete confidentiality is assured.

UNSUBSCRIBE

We will continue to send the newsletter as published at no cost unless you notify us that you wish to be removed from the distribution list. To REMOVE yourself from this list, send an e-mail to: newsletters@mercercapital.com and type the words "Unsubscribe – Value Matters" in the subject line (without the quotation marks).

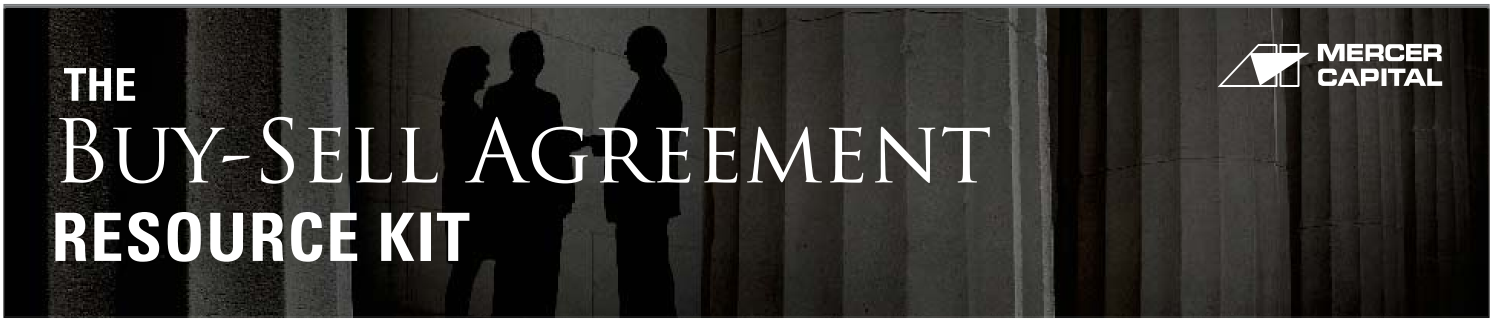
MERCER CAPITAL

Business Valuation » Investment Banking

HEADQUARTERS:
5860 Ridgeway Center Parkway, Suite 400
Memphis, Tennessee 38120
901.685.2120 » Fax 901.685.2199

LOUISVILLE OFFICE:
511 South 5th Street, Suite 206
Louisville, Kentucky 40202
502.585.6340 » Fax 502.585.6345

www.mercercapital.com



SPECIAL OFFER

Get your copy of the
Buy-Sell Agreement Resource Kit
for **only $79**

(Regular price - $129)

Includes the book, *Buy-Sell Agreements: Ticking Time Bombs or Reasonable Resolutions?* as well as the *Buy-Sell Audit Checklist*

The Latest Tool to Help You Craft Buy-Sell Agreements

Mercer Capital's **Buy-Sell Agreement Resource Kit** includes:

» The best-selling book, *Buy-Sell Agreements: Ticking Time Bombs or Reasonable Resolutions?*

» The *Buy-Sell Audit Checklist*, a 40-page "audit tool" that addresses the many obvious, yet overlooked, valuation issues related to buy-sell agreements.

Estate planning professionals must have this resource kit. It is an invaluable aid as you draft and review buy-sell agreements. Authored by a valuation professional, the book and the *Buy-Sell Audit Checklist* can help you avoid the problems and pitfalls of poorly worded or incomplete agreements.

Name

Firm

Address

City/State/Zip　　Telephone

Email

☐ Visa ☐ Mastercard ☐ American Express ☐ Check Enclosed

Card Number

Name on Card　　Exp. Date

Signature

	ITEM	REG. PRICE	SPECIAL PRICE	TOTAL
	Buy-Sell Agreement Resource Kit *(Includes Book & Checklist)*	~~$129~~	**$79**	

Individual Item Orders

	Buy-Sell Agreements: The Book	$79		
	Buy-Sell Audit Checklist	$50		

SHIPPING CHARGES

	1 Kit	2 or More
FedEx Ground	$7.00	$12.00
2-Day	$11.00	$15.50
Overnight	$35.00	$40.00

Please call for Canadian & International rates

Sales Tax - TN Residents (9.25%)	
Shipping Charge	
TOTAL	

MERCER CAPITAL :: 5860 Ridgeway Center Parkway, Suite 400, Memphis, TN 38120 :: 901.685.2120 (P) :: 901.685.2199 (F) :: www.mercercapital.com