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A legal update from Dechert's Corporate and Securities Group

## SEC Approves Rule 2290 Regarding Fairness Opinion Disclosures

To address increasing public concern that fairness opinion disclosures do not adequately address potential conflicts of interest, the Securities and Exchange Commission (SEC), on October 11, 2007, approved new Rule 2290 regarding fairness opinion disclosures and procedures.<sup>1</sup> Rule 2290 was originally proposed by the NASD<sup>2</sup> in November 2004 and was amended four times prior to SEC approval.

### Description of New Rule

Rule 2290 requires that any fairness opinion issued by a FINRA member firm that will be made available to the recipient company's public shareholders must include disclosure to alert such company's public shareholders to any potential conflicts of interest between the firm issuing the opinion and the parties involved in the transaction. While, in general, these disclosure obligations merely codify what already has become customary practice, the following two disclosures required by Rule 2290 may require

FINRA member firms to modify their existing fairness opinion practice:

- Disclosure as to whether or not the fairness opinion was approved or issued by a fairness committee.<sup>3</sup>
- Disclosure as to whether or not the fairness opinion expresses an opinion regarding the fairness of the amount or nature of the compensation to be received in such transaction by the company's officers, directors, employees, or class of such persons, relative to the compensation to be received in such transaction by the shareholders.

The other disclosures required by Rule 2290, which generally reflect what is already common fairness opinion practice, include the following:

- Disclosure of the compensation that the member firm will receive that is contingent upon the successful completion of the transaction, as well as any other "significant" payment or consideration that is contingent upon the completion of the transaction.<sup>4</sup>

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<sup>1</sup> The effective date for the new rule will be announced in a Notice to Members to be published no later than 60 days following October 11, 2007, and the effective date will be 30 days following the publication of the Notice to Members. The full text of the fourth amendment to Rule 2290 can be found at [http://www.finra.org/web/groups/rules\\_regs/documents/rule\\_filing/p019261.pdf](http://www.finra.org/web/groups/rules_regs/documents/rule_filing/p019261.pdf) and the SEC's adopting release can be found at <http://www.sec.gov/rules/sro/nasd/2007/34-56645.pdf>.

<sup>2</sup> In July 2007, the NASD and the member regulation, enforcement, and arbitration functions of the NYSE were consolidated into the Financial Industry Regulatory Authority, or FINRA.

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<sup>3</sup> This disclosure obligation applies with respect to all committees or groups that approve a fairness opinion regardless of whether such group or committee is actually called a "fairness committee."

<sup>4</sup> FINRA has expressly taken the position that this disclosure may be descriptive rather than quantitative. A "significant" payment is one that a reasonable person would want to include in an assessment as to whether the FINRA member firm authoring the fairness opinion has a potential conflict of interest.

- Disclosure of each material relationship that existed during the previous two years or that are mutually understood to be contemplated in which any compensation was or is intended to be received as a result of the relationship between the member firm and any party to the transaction.
- Finally, if any information that formed a substantial basis for the member firms fairness opinion was supplied by the company requesting the opinion, disclosure whether such information has been independently verified by the member firm (and if so, a description of the information or categories of information that were verified).<sup>5</sup>

In addition to the disclosure requirements set forth above, Rule 2290 also will require that FINRA member firms have written procedures detailing their fairness opinion approval process. These written procedures will be required to specify the types of transactions and circumstances in which the member firm will use

<sup>5</sup> The new rule makes clear this disclosure obligation is intended merely to provide information concerning the extent to which information relied on by the member firm was verified and is not intended to require the verification of such information.

a fairness committee to approve or issue a fairness opinion. In addition, the written procedures will be required to include: (i) the process for selecting personnel to be on the fairness committee; (ii) the necessary qualifications of persons serving on the fairness committee; and (iii) the process to promote a balanced review by the fairness committee, which includes the review and approval by persons who did not serve on the deal team.<sup>6</sup> Finally, member firms' written policies will be required to include a process to determine whether the valuation analyses used in the fairness opinion were appropriate.

### Impact on Fairness Opinion Practice

While many of these requirements of Rule 2290 have been incorporated into "best practices," especially for larger FINRA member firms, member firms should review and modify their opinion forms, policies, and procedures in order to ensure compliance with the new disclosure and procedural requirements of Rule 2290.

<sup>6</sup> This does not require the fairness committee be composed of only individuals not serving or advising on the deal team; rather it requires that the member firm have procedures to promote a balanced review by persons who are not serving on or advising the deal team.

### Practice group contacts

For more information please, contact one of the Dechert lawyers listed or the Dechert attorney with whom you regularly work. Visit us at [www.dechert.com/corporateandsecurities](http://www.dechert.com/corporateandsecurities).

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