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SEPTEMBER 2004

U P D A T E

News of Developments in the Financial Sector and Related Areas

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What are Fairness Opinions?

A fairness opinion is a letter prepared by an independent, qualified person generally addressed to the board of directors of a company which addresses the fairness of a transaction, such as a merger, from a financial point of view. The opinion letter does not address whether a transaction is fair from a legal viewpoint, nor is it intended to constitute a recommendation from the point of view of the company. For a transaction to be fair, it only needs to fall in a range of fair market value, which may mean that the price that a shareholder will receive may not be the highest price. The opinion letter is simply the judgment of an independent and experienced professional that the terms of a transaction are fair to the company's shareholders. Since the enactment of the *Sarbanes-Oxley Act of 2002* a greater responsibility has been placed upon members of boards of directors to make informed business decisions. The board of directors maintain the responsibility for recommending what is in the best interest of shareholders of the company. As a result, an opinion letter is not intended to constitute a recommendation as to how shareholders should vote on a proposed transaction since the board of directors has that responsibility. However, fairness opinions help insulate directors from violating their fiduciary duties to the company and its shareholders as required by the *business judgment rule*. The *business judgment rule* generally holds that directors are not liable for decisions that are made in good faith, on an informed basis and with the belief that the action taken was in the best interest of the company and its shareholders. Although there are no laws requiring fairness opinions, they are customarily utilized in assisting the board of directors of a company in fulfilling their fiduciary duties to the company and its shareholders. Fairness opinions are useful in situations involving transactions when the company has an employee stock option plan, there is a likelihood of dissenting shareholders or management is receiving additional consideration in a transaction, such as deferred compensation or employment agreements.

Hedge Funds

The Securities and Exchange Commission ("SEC") has issued a proposed rule which will require hedge fund advisers to become registered under the Investment Advisers Act of 1940. The proposed rule is the result of a review began in 2003 into the structure, operation and compliance activities of hedge funds, marketing issues, and investment protection issues. It is estimated that approximately 40 to 50 percent of all hedge fund advisers are currently registered with the SEC. Because hedge funds involve a variety of risks, investors in hedge funds are traditionally high net worth individuals and institutional investors, such as insurance companies, financial institutions and pension funds. The proposed rule would also affect the way that hedge funds count their clients. Currently, a hedge fund adviser that has 14 or fewer clients and does not hold itself out to the public as an investment adviser does not have to register. Presently, an investment fund adviser may count each hedge fund, which may contain a number of investors, as a single client. The proposed rule would require hedge fund advisers to look through the funds and to count the number of investors in each fund in determining the eligibility for the exemption. A hedge fund is defined as a fund which is managed aggressively to get maximum rates of returns by using derivatives and swaps, selling short and using arbitrage techniques. A hedge fund will generally be organized as a limited partnership or a limited liability corporation. Depending on the sophistication and type of an investor in a hedge fund, a filing may be required under the applicable provisions of the Arkansas Securities Act of 1959, as amended. However, unlike mutual funds, hedge funds are generally not registered under federal securities laws.

Securities Nonissuer Transactions

The Arkansas Securities Act of 1959, as amended (the "Act") exempts from the filing requirements under the Act "any isolated nonissuer transactions…" This exemption from the filing requirements exempts secondary sales of securities by a nonissuer which are already issued and outstanding by the issuer. The term "nonissuer" is defined under the Act to mean not directly or indirectly for the benefit of the issuer. Under the Act the term "issuer" means any person who issues or proposes to issue any security. Under federal law the term "issuer" includes any person directly or indirectly controlling the issuer. Generally, a principal shareholder or executive officer of an issuer is treated as a control person. The term "controlled" has been defined to mean the power to exercise a controlling influence over the management policies of a company. A person serving as a director of a company establishes a presumption of control although such presumption is clearly rebuttable. Any person who owns more than 25% of the voting securities of a company will be presumed to be in a control position. The isolated nonissuer exemption has been termed "primarily an exemption of last resort" because it is ambiguous and indefinite in its application in that it does not address how many nonissuer sales may be made and still considered isolated transactions. For instance, two or more sales may destroy the exemption depending on a specific fact situation. In addition, controlled persons are in a position to supply the same type of information such as financial statements as would be supplied by an issuer. Depending on the circumstances, a filing under the Act will generally be required to be made and obtained prior to the issuance of securities by an issuer. In the event a filing is not made, the issuer will be strictly liable under the Act to a purchaser of the securities for the amount of the principal investment plus 6% interest and any expenses incurred by the purchaser. Since the nonissuer exemption may not be available to a control person, it is recommended that a filing be made on behalf of the control person in order to avoid the liability provisions of the Act.

Cases, Releases and Rulings

Sava Gumarska v. Advance Polymer Sciences, 128 S.W.3d 304 (Tex. App.-Dallas 2004) reaffirms the proposition that a payment of a letter of credit may not be enjoined unless there is evidence of a material fraud by the beneficiary on the account party or the bank as issuer of the letter of credit.

Mr. Binns is available to meet with your organization or group relating to shareholder issues, increasing capital, regulatory and compliance, areas of profitability, marketing and management responsibilities. He is a frequent speaker on matters regarding mergers, acquisitions, commercial law, securities and banking law. Prior to entering the private practice of law, Mr. Binns was an accountant practicing with an emphasis on securities regulation and regulatory compliance.

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