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U P D A T E

News of Developments in the Financial Sector and Related Areas

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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. A fairness opinion will take into consideration such things as any potential conflicts of interest, the structure of the transaction and comparable transactions. 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, a fairness opinion helps 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 when management is receiving additional consideration in a transaction, such as deferred compensation or employment agreements, and there is an appearance of a conflict of interest.

Preemptive Rights

Preemptive rights are generally referred to as the rights of existing shareholders to maintain their percentage of ownership of a company by having the right to buy a pro rata number of shares of any future

issuances of common stock. Preemptive rights are often bargained for by investors, but usually are not contained in the articles of a company. If preemptive rights are contained in the articles of incorporation, this provision can only be eliminated by a vote of the shareholders. If a company offers more of its stock, shareholders having preemptive rights are afforded the right to buy the shares to keep their percentage of ownership the same. By having preemptive rights, shareholders can maintain their voting control and share of earnings. However, preemptive rights complicate financing. By forcing a company to offer its shares to existing shareholders before it offers the shares to outside investors, these rights can postpone or effectively eliminate the sale of shares by a company to outsiders.

Preemptive rights can also delay funding by an investor by requiring the company to first offer the shares to existing shareholders, creating a barrier to obtain financing by a company. Companies needing adequate financing and having to raise additional capital should consider eliminating preemptive rights if such rights exist in the articles of the company.

May Directors Vote by Proxy

From time to time the question arises as to whether or not a director of a corporation may vote by proxy at a meeting of the board of directors due to circumstances such as being out of town, illness or incapacity. A *proxy* is basically a written authorization directing another person to act in his or her place at a meeting.

Proxy voting by shareholders in a corporation is a well recognized practice, primarily due to geographical limitations, allowing shareholders to vote at a meeting of a corporation on such matters as the election of directors and changes in common or preferred stock. Absent statutory authority for proxy voting by directors, the general rule is that directors may not vote by proxy because they have a fiduciary duty to the corporation and its shareholders.

Once elected, directors become fiduciaries, which means that they hold a special level of trust and confidence to the corporation and its shareholders. This fiduciary duty may not be delegated to others. Directors have basically two primary duties consisting of (i) duty of care and (ii) duty of loyalty.

The duty of care means that directors must be diligent and careful in performing the duties they have undertaken on behalf of the corporation and its shareholders. This duty of care, which is sometimes referred to as due diligence, means that directors should attend and participate in board meetings in order for them to be informed about the corporation's business. In addition, this duty of care means that they must make reasonable inquiry before making a decision. This duty of care also requires them to manage corporate affairs honestly and in good faith, using the level of care that a reasonable prudent person would use under the same given circumstances.

The duty of loyalty means that directors must act in the best interest of the corporation and its shareholders at the expense of their own personal interests, thus prohibiting directors from profiting at the corporation's expense in transactions involving the corporation and its assets. Because a director has the fiduciary responsibility for acting (i) in the best interest of the corporation, (ii) as an ordinarily prudent person would act, and (iii) only after reasonable inquiry, a director may not vote by proxy. However, it has become a generally accepted practice for directors to vote by telephone, so long as everyone present at a meeting can hear each other.

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