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Business Law Section
Committee on Securities Regulation

May 11, 2006

Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-9303

E-mail address: rule-comments@sec.gov

Attention: Nancy M. Morris, Secretary

Re: File No. SR-NASD - 2005-080
NASD Proposed New Rule 2290 (Fairness Opinions)
Release No. 34-53598

Ladies and Gentlemen:

The Committee on Securities Regulation (the "Committee") of the Business Law Section of the New York State Bar Association appreciates the invitation in Release No. 34-53598 (the "Release") to comment on the proposal of the National Association of Securities Dealers, Inc. ("NASD") to adopt a rule dealing with Fairness Opinions (Proposed Rule 2290).

The Committee is composed of members of the New York Bar, a principal part of whose practice is in securities regulation. The Committee includes lawyers in private practice and in corporation law departments. A draft of this letter was reviewed by certain members of the Committee, and the views expressed in this letter are generally consistent with those of the majority of members who reviewed and commented on the letter in draft form. The views set forth in this letter, however, are those of the Committee and do not necessarily reflect the views of the organizations with which its members are associated, the New York State Bar Association, or its Business Law Section.

Summary

The Release solicits comments on Proposed Rule 2290, dealing with fairness opinions issued by NASD member firms in connection with a specified transaction. We agree with certain of the disclosures required under proposed Rule 2290, subject to certain modifications and limitations, and urge that other provisions be eliminated, as described below. For purposes of this letter, "member firm" refers to the NASD member firm rendering a fairness opinion in connection with

a specified transaction, and "company" or "party" refers to a company that is a party to the transaction. The proposed disclosures would be required in the fairness opinion.

We agree, subject to certain modifications, with the proposed disclosure of: (i) whether the member firm has acted as a financial advisor to any company in connection with the transaction; (ii) contingent compensation to the member firm that is subject to completion of the transaction; and (iii) the existence of a material relationship between the member firm and the companies during the past two years or is mutually understood to be contemplated in which any compensation was received or is intended to be received (Rule 2290(a)(1), (2) and (3)). However, we believe that any such compensation or relationship in itself does not create a conflict of interest, and urge the Commission and NASD to clarify in adopting Rule 2290 that disclosure relating to such compensation or relationship does not does not constitute an acknowledgement that a conflict of interest exists.

The proposed disclosure in Rule 2290(a)(3) of material relationships "mutually understood to be contemplated" would cover future relationships and should be limited to three months from the date of the transaction.

In addition, Rule 2290(a)(3) as proposed does not apply to affiliates of the member firm or affiliates of the companies. The Commission specifically asked for comment on whether the disclosure obligation should be extended to affiliates of the member firm. Furthermore, the Release states that NASD noted the proposed Rule does not cover affiliates of the companies, and intends to review the comment letters to the Commission before determining whether to include affiliates in subsection (a)(3). We urge the Commission and NASD not to modify proposed 2290(a)(3) to include affiliates of either the member firm or the companies, within its coverage.

We urge the Commission and NASD not to approve or adopt proposed Rule 2290(a)(4). Subsection (a)(4) would require the member firm to disclose the categories of information supplied by the company, that formed a substantial basis for its fairness opinion, and whether it independently verified each category of supplied information.

In addition, the Commission asked for comment on whether the member firm should be required to describe what type of verification they undertook, and further whether member firms should be required to obtain independent verification of such information. If the Commission were nevertheless to approve 2290(a)(4) notwithstanding our recommendation, it should not require additional disclosure describing the type of verification where independent verification is undertaken. Finally, in all cases, the member firm should not be required to obtain independent verification of any supplied information.

Proposed Rule 2290(a)(5) would require disclosure of whether the fairness opinion was approved or issued by a fairness committee of the member firm. Rule 2290(b), on the other hand, does not require disclosure but instead would dictate the procedures that a member firm would be required to have in its process for approving a fairness opinion.

While we do not oppose proposed Subsection (a)(5), we urge the Commission to disapprove, Rule 2290(b)(3). Even if the Commission were to approve Subsections (b)(1) and (2) of Rule 2290(b) establishing certain procedures, it should in all cases disapprove proposed Subsection (b)(3). Rule 2290(b)(3) would require procedures for member firms to evaluate whether the amount and nature of compensation for officers, directors or employees of companies involved in the transaction relative to benefits of the transaction to shareholders generally is a factor in reaching a fairness determination.. That is not the function of a fairness opinion, which is to evaluate the fairness of consideration or benefits to shareholders generally. Subsection 2290(b)(3) would have the effect of inappropriately imposing on member firms a requirement to evaluate the compensation and other arrangements for directors, officers and employees of the companies. Finally, the proposed Rule should not be modified to add a required disclosure regarding the specific procedures that are used by the member firm.

Discussion

1. The Commission and NASD Should Clarify That Disclosure Of Compensation And Relationships Required By Rule 2290(a)(1), (2) and (3) Does Not Constitute An Acknowledgement That The Member Firm Has A Conflict Of Interest.

The Proposed Disclosure In Rule 2290(a)(3) Of Future Relationships Should Be Limited To Three Months From The Date Of The Transaction, And Should Not Cover Affiliates Of The Member Firm Or The Companies.

We believe that the existence of compensation and relationships disclosed under Rule 2290(a)(1), (2) and (3) does not in itself necessarily create a conflict of interest. We recommend that the Commission and NASD in adopting the proposed Rule clarify that such compensation or relationship does not constitute an acknowledgment that a conflict of interest exists.

Rule 2290(a)(3) requires disclosure of whether there was a material relationship involving compensation that existed in the past two years between the member firm and the companies. However, that subsection also would require disclosure of whether there is any material relationship involving compensation "mutually understood to be contemplated." We recommend that this latter disclosure of a future relationship be limited to the three months following the date of the transaction, so as to avoid an unreasonably broad requirement regarding future events and to reduce the possibility of requiring early disclosure of confidential information unrelated to the transaction.

The proposal for disclosure for a forward looking anticipated transaction exceeds reasonable disclosure requirements and raises insider information issues. By comparison, under NASD Rule 2711, a member firm issuing a research report need only disclose if it intends to seek compensation for investment banking services in the next three months. The disclosure required by Proposed Rule 2290(a)(3) goes beyond that. It could require disclosure of the fact that discussions have been held among the member firm and one or more of the companies as to further business transactions or securities issuances/placements. Rule 2290(a)(3) should be limited, at the very least, to compensation for investment banking services the member firm intends to seek in the three months following the date of the transaction.

Finally, the Commission and NASD should not modify proposed Rule 2290(a)(3) to include affiliates of either the member firm or the parties. We believe that such a broad requirement would not be likely to add much to the more tailored information that would be elicited under the Rule as proposed, and that amplifying the proposed Rule in this respect would impose an unreasonable burden on the member firms, particularly in consideration of the burden and time that would be required.

2. The Member Firm Should Not Be Required To Disclose: (i) The Categories Of Information, Supplied To It By The Companies, That Formed A Substantial Basis For The Fairness Opinion; And (ii) Whether It Independently Verified Such Information -- Proposed Rule 2290(a)(4) Should Be Eliminated.

If Proposed Rule 2290(a)(4) Is Adopted Notwithstanding Our Recommendation, It Should Not Require Disclosure Of The Specific Information Involved In Each Category, And It Should Exclude Any Information That Is Publicly Available In A Filing With The SEC.

In All Cases, The Member Firm Should Not Be Required To Verify The Information, And Should Not Be Required To Disclose Whether It Verified Each Category Of Information.

In the Release the NASD is cited as stating that the specific information supplied by the companies is not required to be set forth, but only the categories of information. If the Rule is adopted as proposed, this clarification should be retained and included in the Rule.

Transactions that would be the subject of a fairness opinion cover a wide gamut. This was acknowledged by the NASD in the rulemaking process when it expanded the coverage of Proposed Rule 2290 from corporate control transactions to all transactions in which a fairness opinion is rendered. The categories of information that a member firm may request to support its opinion will vary from transaction to transaction and will vary by the nature of the transaction.

If Proposed Rule 2290(a)(4) is adopted notwithstanding our recommendation to eliminate the subsection, any information that is publicly available in documents filed with or furnished to the SEC, should be excluded from its coverage. This would include information set forth in Forms 8-K, 10-Q and 10-K, proxy statements and registration statements, filings under Rule 425 and in Schedules such as TO, 13D, 13G, 13E-3 and 13E-4. This publicly available information would be available for review and use by anyone seeking to consider the adequacy of the analysis of a proposed transaction for which a fairness opinion is requested or supplied. Issuers making such filings are subject to severe liability and serious regulatory sanctions if the filings are false or misleading. We believe little would be gained by requiring the member firm to state what efforts, if any, it took to verify the contents of such public filings.

Finally the proposed Rule does not set forth any definition of either the term "verified" or the phrase "independently verified." As a result, the terms are vague and amorphous and there can be no assurance that responses to this disclosure item would be consistent between member firms. It is unclear, for example, whether the term "verified" means that the member firm has conducted the type of due diligence inquiry that an underwriter would conduct in a public

offering, or whether it means more than or less than that. We also note that there is no verification duty imposed upon analysts and member firms issuing research reports under NASD Rule 2711.

The statement in the Release that a statement that the member firm conducted no verification would not be satisfactory is going beyond the function of a member firm in rendering a fairness opinion. If the NASD is trying to impose or imply a duty on member firms to verify, then it is exceeding its rightful authority. Fairness opinions are given in a wide variety of circumstances. Often a banker is called in specifically for this purpose, without necessarily having much or any prior involvement with the companies involved, precisely because the principals or board want an "outside," objective view. The purpose for involving the banker has nothing to do with checking the underlying information and disclosure record, for which the companies are responsible, but is limited to getting the benefit of the banker's judgment and analysis. A verification requirement would therefore impose unwarranted costs and burdens on all involved. This should not be a matter of NASD requirements.

3. The Commission Should Not Approve Subsection 2290(b)(3) Which Would Have The Effect Of Requiring Member Firms To Evaluate Compensation For Officers, Directors Or Employees From The Transaction Relative To Benefits Of The Transaction To Shareholders Generally.

In All Cases, The Commission And NASD Should Not Add A Requirement That A Member Firm Has To Disclose The Procedures It Utilizes For Fairness Opinions.

Proposed Rule 2290(a)(5) would require disclosure of whether the fairness opinion was approved or issued by a fairness committee of the member firm. Rule 2290(b), on the other hand, does not require disclosure but instead would dictate the procedures that a member firm would be required to have in its process for approving a fairness opinion.

If the Commission were to approve Subsections (b)(1) and (2) of Rule 2290(b) establishing certain procedures, it should in all cases disapprove proposed subsection (b)(3). Rule 2290(b)(3) would have the effect of requiring procedures for member firms to evaluate compensation for officers, directors or employees from the transaction relative to benefits of the transaction to shareholders generally. That is not the function of a fairness opinion, which is to evaluate the fairness of consideration or benefits to shareholders generally. Subsection 2290(b)(3) would inappropriately impose on member firms a requirement to evaluate the compensation and other arrangements for directors, officers and employees of the companies. Finally, the proposed Rule should not be modified to require disclosure of the specific procedures that are used by the member firm.

Proposed Rule 2290(b)(3) is almost in contradiction of the Commission's actions in the tender offer best price rule proposal (Release 34-52968) it recently published for comment. Proposed Rule 2290(b)(3) would have the effect of requiring a member firm issuing a fairness opinion to consider, as part of its opinion, the benefits that officers, directors, and other employees would receive relative to the benefits that the shareholders would receive in the transaction. In the Release, the NASD made clear that this does not apply to benefits receivable as a result of pre-

existing contractual arrangements, such as change in control payments. If, notwithstanding our recommendation, Proposed Rule 2290(b)(3) is to be retained, this should be made clear in the rule itself.

Requiring such consideration would impose a duty upon the member firm in issuing its fairness opinion to state directly the effect such benefits had upon its consideration of the fairness of the transaction. If these benefits are disclosed to the shareholders of the company requesting the fairness opinion, there is no reason for the member firm to reflect them or state that it did or did not consider them in rendering its fairness opinion.

In many major transactions involving a publicly held corporation the acquirer would want to make arrangements to assure the continued involvement of key personnel in the acquired company after the transaction is completed, or that these key people will not go in to competition with the acquired company after the transaction is completed. Such arrangements are the subject of the Commission's proposed tender offer best price rule, and are to be excluded from the consideration received if the person who enters into such an arrangement tenders shares into a tender offer for the company employing them. If subsection 2290(b)(3) is adopted, such arrangements should also be excluded from having any effect upon the rendering of a fairness opinion or even being disclosed in connection with the fairness opinion.

We hope the Commission finds these comments helpful. We would be happy to discuss these comments further with the Staff.

Respectfully submitted,

COMMITTEE ON SECURITIES REGULATION

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