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The Honorable Alfonse M. D'Amato
Chairman
The Honorable Paul S. Sarbanes
Ranking Minority Member
Committee on Banking, Housing
and Urban Affairs
United States Senate

The Honorable Thomas J. Bliley, Jr.
Chairman
The Honorable John D. Dingell
Ranking Minority Member
Committee on Commerce
House of Representatives

The Honorable Jim Leach
Chairman
The Honorable Henry B. Gonzalez
Ranking Minority Member
Committee on Banking and
Financial Services
House of Representatives

This letter responds to the requirement of the Limited Partnership Rollup Reform Act of 1993 (Title III of Public Law 103-202, December 17, 1993) that we study the use of fairness opinions in limited partnership rollups. The act was intended to curb abusive practices and provide enhanced investor protection in limited partnership rollup transactions.[1] The act required us to report within 18

[1]Abuses in rollup transactions that occurred before the act passed in December 1993 were documented in Senate Report 103-121, Limited Partnership Rollup Reform Act of 1993, August 3, 1993, and House of Representatives Report 103-21, Limited Partnership Rollup Reform Act of 1993, February 25, 1993.

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months information on factors such as preparation standards, costs, and effects of fairness opinions. However, only one rollup with a fairness opinion, and only five rollups in total, were filed with the Securities and Exchange Commission (SEC) and became effective after the act passed. This small number of rollups provides little basis for a meaningful analysis of the effects that the act has had on the preparation of fairness opinions. If more rollups with fairness opinions are filed in the future, we would be happy to provide additional information at your request.

In a typical, publicly-offered limited partnership, a sponsoring organization solicits funds from investors to purchase assets, such as real estate or oil and gas wells. The sponsor usually serves as the general partner and has the responsibility to manage the assets and fulfill any obligations to the investors under the terms of a partnership agreement. The investors are called limited partners because they have little or no responsibility and liability under the partnership agreement. Investors expect to receive periodic payments during the life of the partnership, and, when the partnership assets are sold, a return of their principal, a specified return or profit, and a portion of any additional proceeds.

In the late 1980s, troubled real estate and oil and gas markets along with tax reform legislation removed the financial benefit of many real estate and oil and gas limited partnerships. This caused financial problems for many general partners. Some sought to restructure original partnership agreements by proposing to reorganize, or rollup, existing limited partnerships into new, publicly-traded companies. A typical rollup combines a number of previously non-traded limited partnerships into a single entity that can be publicly traded on organized securities markets. Thus, partnership rollups convert specified-term, non-traded investments into infinite term, publicly-traded securities. The resulting companies continually reinvest proceeds from asset sales rather than distributing them to limited partners as originally agreed. In some rollups, the general partner would commission an outside firm to develop an opinion on the fairness of the rollup to the limited partners. These fairness opinions were not required by law, but general partners often used them to encourage limited partners to approve a proposed rollup or to gain additional protections under state law.

Although the Limited Partnership Rollup Reform Act required general partners to provide investors information about the fairness of a rollup transaction, it did not require the use of fairness opinions. However, it did require that SEC develop rules to improve disclosure about fairness opinions within 1 year after the act was passed. The act specified that these rules

require general partners to disclose such items as (1) compensation of the preparers of any opinion that is contingent on the transaction's approval or completion; (2) reasons for the general partner limiting the scope of the preparer's investigation in connection with any opinion, if such limitations are imposed; and (3) reasons for the general partner concluding that a fairness opinion was not necessary for the limited partners to make an informed decision on the proposed transaction. Although SEC rules had previously required disclosure of any material information about a fairness opinion, in December 1994, SEC amended these rules to include the specific items of information listed in the act.

The act required us to review a number of factors related to fairness opinions. These include the preparers' standards for determining fairness; the scope of review, quality of analysis, qualifications and methods of selecting preparers; cost of preparation and any limitations imposed by issuers on opinion preparers; the nature and quality of disclosures provided with respect to such opinions; any conflicts of interest with respect to the preparation of such opinions; and the usefulness of such opinions to limited partners.

In order to meet the act's requirements, we discussed limited partnership rollups and the use of fairness opinions with SEC staff and preparers of fairness opinions. SEC staff in the Division of Corporation Finance, which is responsible for the new disclosure rules and for reviewing proposed rollups, told us that they did not expect that the new rules would have a significant effect on the preparation of fairness opinions. They also said that, at the time the legislation was considered, SEC objected to regulation of limited partnership fairness opinions beyond its new disclosure rules because of the potential negative effects of such regulation on other business transactions that use fairness opinions. Representatives of opinion preparers told us that, except for those associated with individual tasks such as real estate appraisal, no standards exist for preparing fairness opinions. They said that it would be difficult to develop standards for preparing fairness opinions because the tasks required for each transaction can be totally different. Some of these issues had been discussed in House and Senate committee hearings before the act passed.

SEC provided us information that showed 51 limited partnership rollups had become effective from January 1991 to June 1995. However, only one rollup had been filed and become effective subsequent to SEC issuing the rules required by the act in December 1994. As discussed above, since the act passed in December 1993, five rollups had been filed and become effective, only one of which contained a fairness opinion. Thus, although

we reviewed this opinion, it does not form a sufficient basis for us to reach conclusions about the issues the act asked us to address.

SEC officials in the Division of Corporation Finance provided oral comments on a draft of this report, which we have incorporated where appropriate. If you have any questions, please call me at (202) 512-8678.

James L. Bothwell
Director, Financial Institutions
and Markets Issues

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