WACHTELL, LIPTON, ROSEN & KATZ

April 3, 1972

To Our Clients

Recent Developments

"Bunching Orders". The SEC has now supplemented its previous no-action position with an amendment to Rule 17d-1 to permit investment companies to bunch orders with related investment companies or other accounts to gain the advantage of negotiated commissions. As proposed, the amendment requires that each participant in the bunched order receive the same net unit prince, the transactions be allocated in proportion to the respective orders and the transaction overall be for the purpose of benefiting the investment company participant. Until the amendment to Rule 17d-1 is adopted, the SEC no-action position continues limited to bunching where only registered investment companies are involved.

"Interested" Directors. There have been a good number of no-action denials by the SEC in this area. The SEC has taken a rather restrictive view of the material business or professional relationship clause, such as finding such relationship where the director was a co-author with an affiliated person and proposed to use the library facilities of the management company and where the director was associated with an executive search firm retained to find an employee for a sponsor. Continual review is necessary to avoid problems.

Board of Directors Audit Committee. The SEC has reiterated its recommendation that public companies have audit committees composed of outside directors to select the auditors and consider the auditors reports and that the auditors address their report to the stockholders, attend stockholders meetings and be elected by the stockholders. In view of the plethora of litigation involving accountants and the continued problems

in the accounting area, failure to follow these standards could be found to lend weight, if not substantially establish, failure of proper accounting. Accordingly, corporations not presently following these recommendations should adopt them.

Sale of Mutual Fund Advisory Contracts. The SEC has in a letter to Senator Williams now confirmed its intention to recommend legislation to overrule Rosenfeld v. Black and permit the sale of advisory contracts. The basic outline of the SEC recommendation is as indicated in our memorandum dated March 13, 1972. The letter to Senator Williams contains this sentence: "The buyer, however, would have to recognize that beyond the term of the initial contract, his satisfactory performance as adviser will be his only assurance of continuing the advisory relationship." (Emphasis supplied.) This is a further recognition that the fund director's duty extends to the quality of performance. This principle relates not just to the reasonable fee question under amended Sections 15 and 36, but to whether the adviser should be continued at all if performance is substandard. This continues to appear as the next major area of derivative litigation.

Installment Sale of Tax Shelters. The FRB has ruled that it is a violation of Regulation T for brokers to sell tax shelters on installment bases.

Downside Out Options. We have recently had occasion to reconsider downside out options of both the Gordon type and the Goldman Sachs type. While the issue is less clear as to the latter than the former, we continue to be of the opinion that they are violative of the margin regulations on the ground that they attract lender type capital from the writers standpoint (rather than the risk type capital writing standard options) and are therefore contrary to one of the basic underlying policies of the margin regulations. Despite the Gordon Boston FRB Letter, it is our opinion that the potential of liability to buyers is too great to warrant brokers or writers to participate in this business.

"Tipping" Recommendations. A recent case, Courtland v. Walston & Co. Inc., holds that favoring certain clients with advance information as to market recommendations is a fraudulent practice violative of the Exchange and Advisers Acts. The case serves as a reminder to research firms of the need to be sure that the firm trading account is not favored over clients and that clients receive equal treatment.

Financial Public Relations. A consent decree in the Pig 'N Whistle case reflects the SEC position that PR firms have a due diligence duty to determine the accuracy of publicity they disseminate for their clients.

Buying Power Determined by Adding SMA Balance. Manevich v. Francis I. duPont, Glore Forgan & Co. holds that the balance in a SMA is properly added in determining buying power in a margin account for Regulation T purposes.

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