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October 9, 1972

To Our Clients:

Recent Developments

Pooling-Of-Interests Accounting - Limitation On Registration Covenants And Sales By Shareholders Of Acquired Company

ASR No. 130, 9/29/72, is an endorsement by the SEC of the APB interpretation that pooling cannot be used if a business combination is conditioned upon take-out of the shareholders of the acquired company by an underwriter or other person.

The SEC will presume the take-out condition and thereby deny pooling if a registration statement is filed registering the take-out shares with financial statements as of a date prior to the effective date of the combination. "In other words, all stock issued in a pooling must be held at risk at least as long as it takes to prepare post-merger financial statements for the combined entity and then to file and await effectiveness of a registration statement before it can be sold."

Agreement to register shares subsequent to the combination does not destroy pooling. But agreement requiring sale of shares or any agreement to reduce the shareholders risk does destroy pooling.

Until December 15, 1972, the SEC will accept as poolings transactions where the registration statement is filed before the date of the combination and becomes effective after the date of the combination and the selling shareholders retain at least 25% of the stock they receive.

It is not clear how the new interpretation will effect S-14 transactions and its relationship to new Rule 145. New Rule 145 will be discussed in our next memorandum.

Early Disclosure of Extraordinary Charges and Write-Offs

The SEC has proposed changes to the reporting and registration forms to require considerable more detail

in connection with write-offs, including five-year pro forma restatement of earnings and projection of when losses will be realized when provisions for future loss is made and a report from the independent accountants stating their examination of the underlying documentation and their opinion as to the fairness of the presentation both actual and pro forma.

In the release proposing the amendments, SA Rel. No. 5313, 10/2/72, the SEC has again called attention to the requirement of prompt disclosure of write-offs and disclosure of facts which may result in write-offs. This can be an extremely sensitive liability matter and give rise to more class actions. The release states: "The Commission has observed an increasing number of large charges to income which have come as a surprise to investors and which have called into question the adequacy of prior years' financial statements. Some of these charges have been of a size and nature such that it might be expected that they could have been foreseen by the entity involved. In this connection, registrants are urged to make special efforts to recognize incipient problems which might lead to these types of charges and to identify them clearly at the earliest possible time in financial statements and other forms of public disclosure, including public reports filed with the Commission, so that investors may recognize the risks involved. In this connection, registrants may consider disclosure of the investment involved in divisions operating at a loss and subject to discontinuance, the undepreciated cost of plant and equipment currently considered to be obsolete or of marginal utility, the extent of research and development costs incurred in connection with products whose success is not reasonably assured and other similar items where significant uncertainties exist as to realization. The Commission has previously urged more comprehensive disclosure of progress and problems encountered in defense and other long-term contracts which may also give rise to major charges against income (Securities Act Release No. 5263 dated June 22, 1972) and has urged greater diligence in the release of information on quarterly and other interim reports of operations (Securities Exchange Act Release No. 9559 dated April 5, 1972)."

Proxy Rules - Shareholder Proposals

Effective January 1, 1973, Rules 14a-5 and 14a-8 are amended so as to:

(1) Require that the first page of the proxy statement be dated with the approximate date of mailing and contain the address of the principal executive offices of the company. (14a-5)

(2) Change from 100 to 200 words (but now inclusive of whereas clauses) the supporting statement accompanying a shareholder proposal. (14a-8(b))

(3) Preclude all proposals not significantly related to the company's business, not within the Company's power to effectuate or which relate to personal claims or grievances against the Company by any other person. (14a-8(c)(2))

(4) Advance the entire timing sequence in 14a-8(d) by 10 days -- proposals must now be received at the Company's principal executive office not less than 70 days prior to the date corresponding to the date set forth on the prior year proxy statement.

Brokers SEC Reports -- SIPC Assessments

Effective October 15, 1972, Rule 17a-5 is amended to require brokers to file a supplemental schedule to 17a-5 annual reports detailing SIPC assessment payments which schedule is to be accompanied by a report of the certifying accountants that the SIPC assessment payments were "determined fairly in accordance with applicable instructions and forms or that a claim for exclusion from membership was consistent with income reported."

Mutual Funds -- Post Effective Amendments

In connection with the transfer of investment company registration statement processing to the Division of Corporation Finance, SA Rel. No. 5305, 9/21/72, states:

(1) Corporation Finance will follow the same procedures for deferred, cursory, summary and customary review of mutual fund post effective amendments as are followed

for other registration statements in accordance with SA Rel. No. 5231, 2/3/72.

(2) The narrative part of the post effective amendment must be filed two months before the end of the fund's fiscal year (November 1 for calendar year funds) and when financials are available, they should be filed formally in a second post effective amendment containing the whole registration statement and reflecting changes in the narrative part in response to comments. The second filing is to be accompanied by a letter of counsel noting changes and compliance with comments.

(3) With respect to "regulatory questions", counsel should identify any such in a letter accompanying the filing of the narrative part and provide an opinion that "its resolution and disclosure, if any, are consistent with applicable law." Presumably, this requires counsel to identify and resolve such matters as whether directors are "interested", § 15(c) has been complied with on renewal of the advisory contract, and the handling of recapture, negotiated commissions, compensation for research, sales reciprocity, etc. A difficult task in view of the rapidly changing standards in these areas.

REIT Commercial Paper

In Gulf Mortgage and Realty Investments, 9/18/72, a no action position was taken with respect to nine-month or shorter notes; $50,000 or more denomination; sold in the usual commercial paper market through dealers or directly; and proceeds for three year construction loans or three to five year standing mortgage loans with expectation but not commitment for long-term takeout. A no action position was denied for proceeds used for two-to-three-year development loans to finance acquisition and preparation of land for sub-division or other use.

Rosenfeld v. Black

(a) Newman v. Stein, CCH ¶93,547 (2d Cir. 1972). In approving a $5MM settlement of the Dreyfus Fund case, which involved a public offering of the adviser on a basis that represented an excess over book value of $35MM, Judge Friendly reviewed (without approval or disapproval) the

bases on which a sale to a third party new adviser, as in Rosenfeld, could be distinguished from a public offering (or merger with financial conglomerate) -- no sale of office in that the same adviser continued under same management and the value of the distribution and other functions of the adviser could be separated from the value of the advisory relationship. The petition for certiorari in Rosenfeld has been withdrawn as a result of a settlement.

(b) White v. Auerbach, CCH ¶93,617 (S.D.N.Y. 1972) contains a more extensive discussion than Newman of the bases on which Rosenfeld can be distinguished, including the value of the employees who continue to perform advisory functions.

(c) Kukman v. Baum, CCH ¶93,602 (N.D. Ill. 1972). On the basis that the 1970 Amendments to the ICA intended to reject the SEC additional burdens test and approve the Insurance Securities case, the court, in a situation where the operating management continued, held that Rosenfeld was not a correct statement of the law and declined to follow it.

(d) King v. Kansas City Southern Industries, Inc., CCH ¶93,587 (N.D. Ill. 1972) discusses the status of a Rosenfeld type case as a class action, derivative action or direct action and decides against class action.

(e) Pending Legislation -- Senator Williams in his speech to the SIA on September 7, 1972 stated an intention to amend the pending SEC bill to overrule Rosenfeld, Sen. 3681, 92 Cong. 6/7/72, so as to change the requirement from 100% unaffiliated directors for 5 years to 75% unaffiliated directors for 3 years, but otherwise retain the pending proposals which would require shareholder approval, one year initial term for the new contract and new contract terms not less favorable to the fund than under the old contract.

Liability under 10b-5 to Shareholders who Buy before, and did not Sell During, the Defendants 10b-5 Violations

In re Penn Central Securities Litigation, CCH ¶93,610 (E.D. Pa. 1972) holds that 10b-5 does not extend to the existing shareholder who buys before the fraud and continues to hold

while the fraud is committed and the price declines. A similar position is taken with respect to § 9(a) of the 1934 Act and §§ 11(a) and 17(a) of the 1933 Act. The court also denies implied liability under § 13(a) of the 1934 Act taking the position that § 18 is the exclusive liability provision for false 1934 Act reports.

M. Lipton