WACHTELL, LIPTON, ROSEN & KATZ

October 18, 1972

To Our Clients:

Recent Developments

Sale of Control. In Northway, Inc. v. TSC Industries, Inc. (N.D. Ill. 1972), it was held that it is not a 10b-5 violation for the controlling shareholder to sell without obtaining equal opportunity for the other shareholders and, absent circumstances showing that the controlling shareholder knew or should have known that the buyer would defraud the corporation, the seller of control has no liability for the fraud or mismanagement of the buyer. The opinion accepts the view that sale of control at a premium is not illegal and there is no requirement of equal opportunity or notice.

Sale of Investment Advisers. S. 4071 introduced by Senators Williams and Bennett would overrule Rosenfeld v. Black provided certain conditions are met and make clear that the Rosenfeld v. Black principle is not applicable to mutual fund advisers going public such as the Dreyfus Fund case. The Bill differs from the original SEC proposal and is as described by Senator Williams in his September 7 speech to the SIA as noted in our memorandum dated September 18, 1972. Under the Bill there would be no limit on the consideration for sale of the stock or assets of an adviser if:

(1) for three years after the sale 75% of the fund's directors are not interested persons of the new or old adviser and

(2) there is no "unfair burden" imposed on the fund.

Unfair burden is described as any arrangement during the two-year period following the sale for the old or new adviser to receive compensation from the fund other than as adviser or distributor -- thus precluding the adviser from acting as broker for portfolio transactions by the fund. This is consistent with the provisions of the Bill banning advisers from doing the exchange portfolio brokerage for their funds (see below), but until such ban becomes effective, inconsistent with the former SEC policy of encouraging recapture for the benefit of the fund and would preclude transactions in which the management fee is reduced as the result of the transfer of the adviser to a member firm.

The disinterested directors must be chosen by the disinterested directors and elected by the shareholders. The SEC is instructed, in passing on 6(c) applications for relief

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from the 75% disinterested director rule, to take into account discrepancy in the size of the funds where a large fund acquires a small fund. In reaching their annual 15(c) determination as to the reasonables of the advisory fee, the directors of a fund are proscribed from taking into account the consideration paid to acquire the adviser.

The subsection [15(f)(3)] of the Bill designed to cover the Dreyfus Fund case is drafted badly in that it makes inapplicable the no limit on adviser sale consideration subsection in its entirety not just the 75%-disinterested-director and unfair-burden provisos as is the obvious intent.

Brokerage for Research. The Williams Bill expressly legitimatizes, by amendment to § 36 of the ICA, brokerage commissions (in excess of what could otherwise be negotiated) for research if for the benefit of the fund, disclosed to the shareholders in accordance with rules to be prescribed by the SEC and the broker is not the adviser or an affiliate of the adviser. A similar amendment would be made to § 206 of the IAA to cover non-fund advisory accounts.

Institutional Membership. The Williams Bill follows the September 7 SIA speech by Senator Williams as noted in our September 18, 1972 memorandum. The major differences from the SEC proposed rule 19b-2 are that pension funds are included in the "affiliated" category and 80/20 becomes 100/0 -- no brokerage for "affiliated" accounts. There is no exception for affiliated account brokerage even though it is done without any commission charge.

NYSE Rule 394. Congressman Moss has introduced a bill to invalidate NYSE Rule 394 restricting the right of a member to effect trades off the floor.

Call of Convertible Securities; Standby Agreements. In a ruling letter available September 28, 1972 issued to Salomon Brothers, the SEC takes the position that while the customary standby agreement does not destroy the 3(a)(9) exemption, if the standby underwriter acquires a substantial block, reoffering is not exempt under 3(a)(9) (which is a transaction as distinguished from security exemption) and the requirement for registration would depend on intention to distribute, amount involved and the manner of reoffering.

Waddell & Reed Complaint. The SEC has ordered proceedings on the ground that reciprocal recapture arrangements by an affiliate of the adviser did not benefit the fund and that the adviser used the fund's custodian bank relationship to provide compensating balances for loans to the adviser.

M. Lipton