WACHTELL, LIPTON, ROSEN & KATZ November 14, 1972

To Our Clients:

RECENT DEVELOPMENTS

Disclosure; Forecasting; Inside Information.

The SEC, led by Chairman Casey, is moving far and fast in the disclosure area. There seems little doubt that earnings forecasts and budgets will be required disclosure items in the near future. The SEC appears to believe that regular quarterly earnings forecasts by public companies would go a far way toward solving the inside information "leak" problem and the selective relevation to analysts problem.

A statement in a recent speech by Chairman Casey about accounting principles is worth quoting:

> The primary requirements in this area are a willingness to insist on reporting which makes sense and on disclosure which adequately sets forth all information which is needed by investors. Minimum acceptable practice under a series of specific rules is not sufficient. Least common denominator accounting, where one corporation gets away with slightly sub-par disclosure on accounting and many entities then seek to use this as a precedent for sinking to the same level, is not acceptable to the courts, the Commission or the public.

Accountants are now responding to the problems of the past five years. The "creative" accounting game is just about dead.

The settlement in the SEC suit against IDS for using inside information provides important guidelines for determining what is inside information and how the problem is to be handled. The following is the statement of policy IDS adopted as part of the settlement:

> This statement represents the policy of Investors Diversified Services, Inc. ("IDS") with regard to the receipt and use of material inside (non-public) information.
>
> (1) Court and SEC administrative decisions interpreting Rule 10b-5 promulgated under the Securities Exchange Act of 1934 make it unlawful for any person to trade or recommend trading in securities on the basis of material, inside (non-public) information.
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> (2) Material inside information is any information about a company or the market for the company's securities which has come directly or indirectly from the company and which has not been disclosed generally to the marketplace,

the dissemination of which is likely to affect the market price of any of the company's securities or is likely to be considered important by reasonable investors, including reasonable speculative investors, in determining whether to trade in such securities.

(3) Information should be presumed "material" if it relates to such matters as dividend increases or decreases, earnings estimates, changes in previously released earnings estimates, significant expansion or curtailment of operations, a significant increase or decline of orders, significant merger or acquisition proposals or agreements, significant new products or discoveries, extraordinary borrowing, major litigation, liquidity problems, extraordinary management developments, purchase or sale of substantial assets, etc.

(4) "Inside" information is information that has not been publicly disclosed. Information received about a company under circumstances which indicate that it is not yet in general circulation and that such information may be attributable, directly or indirectly, to the company (or its insiders) should be deemed to be inside information. As a rule, one should be able to point to some fact to show that the information is generally available; for example, its announcement on the broad tape or by Reuters, The Wall Street Journal or trade publications.

(5) Although, to supplement its own research and analysis, to corroborate data compiled by its staff and to consider the views and information of others in arriving at its investment decisions, IDS, consistent with its efforts to secure best price and execution, allocates brokerage business to those broker-dealers in a position to provide such services, it is the policy of IDS not to allocate brokerage in consideration of the furnishing of material inside information, and IDS employees, in recommending the allocation of brokerage to broker-dealers, should not give consideration to any material inside information furnished by any broker-dealer.

(6) Whenever an IDS employee receives material information about a company which he knows or has reason to believe is directly or indirectly attributable to such company (or its insiders), he must determine that the information is public before trading or recommending trading on the basis of such information or before divulging such information to any person who is not an employee of IDS or a party to the transaction. If he has any question at all as to whether the information is material or whether it is inside and not public, he must resolve the question or questions before trading, recommending trading or divulging the information. If any doubt at all remains, the employee must consult with the Law Department.

(7) IDS employees have no obligation to the investment companies advised by IDS which requires IDS or its employees to trade or recommend trading on the basis of material, non-public information in their possession. IDS employees' fiduciary responsibility to the IDS Funds does not require that they disregard the limitations imposed by the Federal securities laws, particularly Rule 10b-5.

(8) If there is any unresolved question whatsoever in an employee's mind as to the applicability or interpretation of the foregoing standards or the propriety of any desired action, the matter must be discussed with the Law Department prior to trading or recommending trading.

The Senior Vice President - Investment Operations is responsible for the implementation of this statement of policy. This statement will be distributed to all traders and Investment Department personnel and will be issued and explained to all new personnel who are so employed at the time of their employment. In addition, periodically, and at least quarterly, representatives of the Law Department will meet with the traders and Investment Department personnel to review this statement of policy, including any developments in the law and to answer any questions of interpretation or application of this policy and, from time to time, representatives of the Law Department will review records maintained in connection with trading or recommending trading in securities and allocation of brokerage.

From time to time this statement of policy may be revised in the light of developments in the law, questions of interpretation and application, and practical experience with the procedures contemplated by the statement.

Investment Company Recapture.

The uncertainty as to the legislative and regulatory treatment of fixed commissions continues. The present situation, particularly the Antitrust Division's comments on 19b-2 and the November 3 Baker speech which reiterate the Division's position that fixed commissions violate the antitrust laws, raises the question as to whether investment companies have a duty to attack fixed commissions and sue to recover for past violations. In light of Moses v. Burgin it would seem prudent to at least have the directors consider the question. The more interesting (read "difficult") questions are whether the directors in reaching their decision can take into account the impact on relations with brokers, the effect on the securities industry in general, the pending legislation and rule making and the SEC's request to hold off pending new legislation or rules.

Mutual Fund Sales Reciprocity.

The ICI objects to the NASD proposal (and the basic SEC position) to end sales reciprocity on the grounds that (a) where the fund directors have decided that sales reciprocity is in the fund's interest, it is not distinguishable from the permitted use of brokerage for research, and (b) it is unfair to proscribe sales reciprocity for mutual funds, but not for investment counsellors, banks, insurance companies, etc. The ICI argues that sales reciprocity should be permitted where approved by a majority of independent directors.

The complaint in Continental Investment Corporation, IC Rel. No. 7417 (10/11/72), CCH ¶ 79,024, alleges that reciprocity arrangements that do not benefit the fund through reduction of the advisory fee and use of the fund's cash deposits with the custodian bank to satisfy the advisor's compensating balance requirements are violations of the ICA.

Investment Company Loans of Portfolio Securities.

Salomon Brothers, CCH ¶79,056 (9/29/72) revises State Street Bank and Trust Co., CCH ¶ 78,676 (12/27/71) so that the guidelines for an investment company loaning its portfolio securities now are:

(a) The investment company receives from the borrower cash collateral equal to 100% of the market value of the loaned securities and such cash collateral is used for the benefit of the investment company;

(b) The borrower is required to mark to the market on a daily basis;

(c) The loan may be called by the investment company at any time (the former requirement of retention of voting rights of the loaned securities is revised so that the investment company's obligation to vote when its investment interest may be affected is satisfied by ability to call loan in time to exercise voting rights);

(d) The investment company receives dividends, interest, or other distributions on the loaned securities and any increase in market value of the loaned securities (former requirement of interest from the borrower on the loan is revised so that it is sufficient that the investment company receives interest on investment of the cash collateral);

(e) The investment company does not pay any service, placement or other fees in connection with the loan.

Rule 144

National Stock Exchange, CCH ¶ 97,095, rules for the purpose of determining the 144 volume limitation that where a stock is traded on the National Stock Exchange and NASDAQ, the NASDAQ volume may be used in lieu of the NSE volume, but the two may not be combined.

Saga Administrative Corporation, CCH ¶ 79,027, rules that where a donor and a donee both sell under 144 in a six-month period, in determining the number of shares that the donee can sell only the donated shares are aggregated with the donor's sales.

Intertherm, Inc., CCH ¶ 79,055, rules that a 10% shareholder and his corporation are not the same person for tacking purposes -- only for aggregating purposes. This seems to be wrong and if it arises again, the SEC staff might change its position.

Mergers - Rule 133

While Rule 133 will be replaced by Rule 145 on January 1, 1973, it will continue to apply to resales of securities received in transactions governed by Rule 133. In Dillon Companies Inc., CCH ¶ 79,057, the SEC staff took the following positions:

(a) the Rule 133 limitations on sales by affiliates of the acquired company are not affected by "change of circumstances",

(b) such limitations do not necessarily expire after two years, and

(c) Rule 144 supplants Rule 133 as to affiliates of the acquired company who become affiliates of the acquiring company.

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