

May 24, 1973

To Our Clients

Investment Companies - Valuation of Nonmarketable Securities. An investment company can delegate to a committee the board of directors Section 2(a)(41) valuation function between board meetings under guidelines established by the board. Paul Revere Investors, Inc. CCH ¶ 79,362.

Sales Reciprocal. On May 14, 1973, the SEC concurred in the NASD rule prohibiting mutual fund sales reciprocals and requested the NASD to extend the application to distribution of closed-end funds. The NASD rule, Art. III, § 26(k) of the Rules of Fair Practice became effective May 15, 1973.

Suitability. A broker's failure to conduct a proper investigation of an investment and inform the customer of its findings can be the basis for 10b-5 liability and violation of the NASD suitability rules can provide the basis for 10b-5 liability, Cash v. Frederick & Co., E.D. Wisc., Nov. 30, 1972, CCH ¶ 93,967.

Tender Offers. Mosinee Paper Corp. v. Rondeau, W.D. Wisc., Feb. 13, 1973, rejects the contention that open market purchases over a four-month period of 8% of a company's stock constitutes a "tender offer" under § 14(e).

Short-Swing Profits. The Supreme Court in Kern County Land Co. v. Occidental Petroleum Corp. has affirmed the Second Circuit holding that the defeated takeover 10% purchaser does not sell in violation of § 16(b) when the target effects a defensive merger within six months and that a true call-option is not a sale within § 16(b).

Inside Information. In Schien v. Chasen, 2d Cir., May 10, 1973, CCH ¶ 93,984 it was held that the New York rule (Diamond v. Oreamuno) that a corporation can recover insider trading profits from the insiders extended to noninsider tippers and tippees.

Proxy Disclosure. Negligent omissions or misstatements violate 14a-9 and unlike 10b-5 and 14(e) scienter is not required; 14a-9 creates a form of absolute liability approaching § 11 of the 1933 Act. Materiality in a 14a-9 case is measured by the "would" effect the shareholder decision test rather than the "might" test; the measurement of materiality is a function of the degree of culpability. Failure to disclose intention to liquidate substantial assets and the probability, based on offers, that sale prices would be substantially in excess of book value violated 14a-9. Gerstle v. Gamble-Skogmo, Inc., 2d Cir., May 9, 1973, CCH ¶ 93,893.

Confirmations. A recent case raises the issue whether disclosure of a trade as a "principle" transaction satisfies the requirement of Rule 15c1-4 of disclosure of transactions as a "dealer". While we think an adverse holding unlikely, perhaps the boilerplate on the back of confirmations should be changed to read: "This is a principal transaction in which we acted as a dealer, rather than as a broker, and the purchase or sale was for our own account rather than to or from a third party."

Equity Funding Corp. Losses. In order to establish short term capital losses in EQF securities held as capital assets it is necessary to make actual sales within six months of purchase. Treas. Reg. 1.165-5(c) provides that "worthless securities" are deemed sold on the last day of the taxable year. Special problems are involved for those who are suing for rescission or other remedies and it is necessary to coordinate carefully the tax and litigation strategy.

M. Lipton