TO OUR CLIENTS:

1. Disclosure of Illegal Political Contributions. On March 8 the SEC announced that it considers conviction or indictment of a corporation, or any of its officers or directors, for making an illegal political contribution to be a material fact required to be disclosed through public announcement and in proxy statements and annual reports. The SEC said: "Such disclosure should include, in addition to a description of the details of the conviction or the plea and the penalty imposed, and as appropriate, information as to whether any funds of the corporation used to make the contribution, directly or indirectly, will be paid back by the officer or director, whether the corporation or its insurers have paid or reimbursed, or intend to pay or reimburse, any officer or director for any fines imposed or legal fees or other expenses of his defense". In addition the SEC said that the disclosure should cover the tax consequences, whether the corporation will seek reimbursement and the steps taken to prevent recurrence. The SEC did not take a firm position on whether disclosure is required of illegal contributions which have not become subject to formal proceedings, but implied that disclosure should be made.

The SEC's rationale--such information is "material" to an evaluation of the integrity of the management of the corporation as it relates to the operation of the corporation and the use of its funds"--would appear to be equally applicable to the question of disclosure of suits against lawyers and accountants, and as the proxy season approaches, this subject will have to be addressed in light of the current SEC position. We continue to feel that, unless the suit affects the corporation, such litigation is not material in the context of shareholder ratification of accountants or the customary situations where counsel is referred to. However, from both a securities law and general corporate law standpoint, we feel that the board of directors or a committee thereof should consider the qualification of the professionals serving the corporation and make a formal determination that such litigation is not indicative of incompetence of the professional firm as a whole or the persons working on the corporation's affairs and is not likely to affect the corporation. Accounting firms might be well advised to have completely independent counsel review all litigation against the firm and any corrective measures subsequently taken by the firm with a view toward a report that can be furnished to clients for such evaluation purpose.

2. Brokers Use of "Divisions". In Fred Alger & Co., CCH ¶79,651 (Avail. Dec. 12, 1973), the SEC approved the use of an acquired brokerage firm's name as a division of the parent brokerage firm, provided that there is clear identification of the parent as the firm with which the public is dealing.

3. Tender Offers - Publication - Regional Newspaper. In Advanced Systems, Inc., CCH ¶ 79,653 (Avail. Dec. 17, 1973), the SEC took the position that it is not a violation of the Williams Act to publish a tender offer only in the area where most of the shareholders reside.

4. Resale of Securities Issued in a 3(a)(10) Reorganization. American Commonwealth Financial Corp., CCH ¶ 79,659 (Avail. Jan. 4, 1974) sets forth the SEC position on resale of securities issued in a 3(a)(10) reorganization. Essentially the SEC position is that such securities are not "restricted" for Rule 144 purposes, non-affiliates who receive not substantial amounts in relation to the total issued in the reorganization are completely free under §4(1), affiliates of the surviving corporation may use Rule 144 without any holding period and holders of restricted securities at the time of the reorganization who receive securities of the surviving corporation are subject to a three-year holding period computed from the date the restricted securities were originally acquired ("tacking" is permitted).

5. Combination Annual Report to Shareholders and Form 10-K. The SEC has stated the following conditions for companies desiring to issue a combined annual report and 10-K:

> 1) The consolidated report shall contain full and complete answers to all items required by Form 10-K. Also, if the responses to a certain topic of disclosure required by Form 10-K are substantially separated within the consolidated report, there should be appropriate cross-references in the consolidated report. If the consolidated report omits the information required by Part II of Form 10-K in reliance upon General Instruction H of the form, a definitive proxy or information statement shall be filed in accordance with the provisions of Instruction H.
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> 2) Any additional information or exhibits contained in the consolidated report shall meet the requirements of Rules 12b-20 and 12b-30 under the 1934 Act.

3) For purposes of filing the annual report pursuant to the 1934 Act, the Form 10-K cover page, the answer to Item 10 of Form 10-K and the Signatures required by Form 10-K shall be included. In addition, a cross reference sheet should be filed with the Commission showing the location in the consolidated report of the information required to be included in Part I or Parts I and II, if General Instruction H(a) is not relied on for the omission of Part II.

4) Any pictorial or graphic representation in the consolidated report shall comply with the provisions of Guide 8 of the Guides for Preparation and Filing of Registration Statements (Securities Act Release No. 5171 (July 20, 1971)).

5) There shall be included in the consolidated report an appropriate disclaimer of any action on the part of this Commission to approve or disapprove the report or to pass upon its accuracy or adequacy.

Teradyne, Inc., CCH ¶ 79,660 (Avail. Dec. 11, 1973).

6. Duty of Major Shareholder in Connection with a Merger. A major shareholder of a Delaware corporation who does not exercise control of the corporation may still owe a fiduciary duty to the other shareholders in connection with approval or rejection of a merger. Absent control over the other party, the major shareholder of one party to a merger has no fiduciary duty to the shareholders of the other party. Harrington v. E.I. DuPont De Nemours & Co., CCH ¶ 94,399 (D. Del. Jan. 16, 1974).

7. 10b-5--Purchaser-Seller Requirement. In Leasco Data Processing Equip. Corp. v. Maxwell, CCH ¶ 94,403 (S.D.N.Y. Feb. 7, 1974), the court held that an unconsummated contract for the sale of securities provided the 10b-5 "sale" necessary to support a cause of action predicated on a scheme to mismanage the corporation and depress the price of the securities which were the subject of the contract.

8. Tender Offers; Materiality; 10b-5; Proxy Disclosure. The decision in Smallwood v. Pearl Brewing Co., CCH ¶ 94,405 (5th Cir. Feb. 19, 1974), contains a number of interesting holdings:

(a) Despite the Seventh Circuit decision in Eason, the Birnbaum-purchaser-seller rule continues in the Fifth Circuit, at least in damage actions.

(b) The purchaser-seller rule does not apply to a Williams Act §14(e) cause of action; a nontendering shareholder may have a cause of action.

(c) A "tender offer" is not limited to a hostile takeover bid; it is to be interpreted so as to effectuate the broad purposes of the securities laws.

(d) A letter to shareholders sent immediately after a merger announcement is not necessarily a "proxy solicitation".

(e) Despite the use by the Supreme Court of "might" in Mills and Affiliated Ute, the test of materiality is whether the fact "would" have been considered important by a reasonable investor.

(f) Negligence is not enough; some culpability is necessary to establish 10b-5 or §14(e) liability for damages.

(g) Adequacy of disclosure can be measured only by considering the total mix. Buried facts may make a statement misleading; readily available public information may cure an ommission. The opinion of the court on this point is especially quotable:

> We cannot accept the premise that prior disclosure in one communication will automatically excuse omissions in another. As we indicated above, the adequacy of disclosure is a function of position, emphasis, and the reasonable anticipation that certain future events will occur. Perception of future events make take on a different cast as the future approaches, and, what is more important, later correspondence may act to bury facts previously disclosed. A balance once struck will not ensure a balance on the future. As new communications add a dash of recommendation, a pinch of promise, and a dusting of repetition, the scale may be tipped. To prevent an injustice to the shareholders, the elements must be weighed each time that the shareholders are requested (or encouraged) to make a new decision. See Chris-Craft Industries, Inc. v. Piper Aircraft Corp., supra, 480 F.2d at 365 n. 18.
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> We do not imply that previously disclosed facts may not be considered in the balance. Nor do we imply that a material fact must be disclosed in each communication or be repeated before each shareholder

> decision in order to avoid a violation of the securities laws. Facts may be adequately disclosed by emphasis or repetitions in previous correspondence by the same parties or through outside sources. In Johnson v. Wiggs, 5 Cir. 1971, 443 F.2d 803, for example, this Court held that information reported in the newspapers and on television and readily available in any brokerage house was sufficiently "in the public domain"; the defendant did not need to disclose "that which had been publicly proclaimed in several ways on several occasions". Id. at 806. Nevertheless, we emphasize that the adequacy of disclosure can be measured only by considering the total mix.

9. Rule 145. On February 28, the SEC issued a general interpretative release with respect to Rule 145. SA Rel. No. 5463, CCH ¶ 2278. We are in the process of updating our Rule 145 memorandum to incorporate the new release.

10. Directors' Responsibilities. In a February 21 speech, SEC Commissioner Sommer reviewed the law as to directors' responsibilities. He cautioned that the majority opinion in Lanza v. Drexel, requiring more than negligence to hold a director liable for non-disclosure in a sale of securities situation, may not be the law, and endorsed the dissenting opinion which would predicate liability on the ground that a director with financial sophistication and knowledge of the facts has a duty to inquire as to whether the buyers of securities from the corporation have been informed fully of the facts. Commissioner Sommer endorsed the concept of differenting among directors for the purposes of determining liability under the federal securities laws on the basis of experience, knowledge, relationship to the corporation and management, intimacy of involvement in the corporation's affairs and awareness of the consequences of the corporate acts-a concept that would result in more liability for lawyer and investment banker directors than others. He proposed that,

(a) corporations adopt guidelines for directors performance;

(b) corporations furnish directors with full information on a regular ongoing basis;

(c) boards be particularly sensitive to issuances of securities;

(d) an audit committee be formed; and

(e) persons be particular in determining whether they will serve as a director, based in large measure on the corporation's policies with respect to directors' performance.

11. Merger Consultants as Brokers. In a series of letters the SEC has been taking an increasingly more assertive position with respect to merger "consultants" being required to register as broker-dealers. In the most recent May-Pac Mgt. Co., CCH ¶ 79,679 (Avail. Dec. 20, 1973) the SEC stated that if the "consultant" does anything more than merely bring the parties together, registration as a broker-dealer is required. Participation in the negotiations or advising as to terms or desirability requires registration.

12. Investment Companies--Proposed Rule 17d-1-The SEC has proposed an amendment to Rule 17d-1 under the Investment Company Act which would permit an investment company to enter into a service agreement with an affiliate provided that the agreement is approved and renewed in the manner required for advisory agreements and provided that a majority of the disinterested directors determine that (i) the agreement is in the best interests of the investment company and its shareholders, (ii) the services to be performed are required for the operation of the investment company, (iii) the services which are provided are at least equal to those which are available from others and (iv) fees paid the affiliate are fair and reasonable in light of the usual and customary charges made by others for services of the same nature and quality. In the release proposing the amendment the SEC noted that the amendment, if adopted, would not diminish in any way the §36 fiduciary obligations. ICA Rel. No. 8245 (Feb. 25, 1974) CCH ¶ 79,667.

13. 1934 Act Reporting Requirments. In DuPont v. Wyly, BNA No. 241 (Feb. 27, 1974), A-23, the District Court for Delaware holds that an action for injunctive relief may be brought under Section 13(a) of the 1934 Act notwithstanding that an action for damages may be brought only under Section 18.

14. Rule 147. In North American Acceptance Corp., BNA No. 241, C-1 (avail. Feb. 18, 1974), the staff of the SEC takes the position that an issuer engaged through subsidiaries in interstate business cannot convert itself to a local business and thus satisfy the 80% requirement of Rule 147 with respect to its revenues and assets during its most recent year by transferring its investments in such interstate subsidiaries to the corporation which owns substantially all of the issuer's stock.

15. Mandatory Reinvestments of Mutual Fund Distributions. In NEA Mutual Fund, Inc., BNA No. 241, C-2 (avail. Feb. 16, 1974), the staff of the SEC takes the position that a mutual fund which requires holders of less than 100 shares to reinvest distributions in additional

shares but which permits other shareholders to elect to receive cash or additional shares violates Section 18 of the Investment Company Act since the securities of the holders of more than 100 shares would have a priority as to payment of dividends and would thus represent "senior securities" which under Section 18(f) mutual funds are prohibited from issuing.

16. Transfer of Advisory Agreements. In Florida Bank Fund, Inc., BNA No. 241, C-5 (avail. Feb. 18, 1974), the staff takes the position that in a situation where a change in ownership of the adviser constitutes an assignment of an advisory agreement subject to shareholder approval, the adviser can continue as adviser performing services and satisfying its obligations under the advisory agreement until the required shareholder approval is obtained provided that it does not receive any compensation from the investment company.

17. Limited Partnership Interests. In Roberts, Scott & Co., BNA No. 241, C-3 (avail. Feb. 12, 1974), the staff states that a a general partnership interest in a limited partnership may be functionally equivalent to a voting security and if the interest is greater than 10% the general partner's shareholders would have to be included in determining the number of beneficial owners of the partnership.

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