WACHTELL, LIPTON, ROSEN & KATZ

April 5, 1974

To Our Clients

Recent Developments

1. Rule 10b-5; Tipper and Tippee Liability; Unlimited Liability for Open-Market Trading. On April 3, 1974 the Second Circuit affirmed the lower court decision in Shapiro v. Merrill Lynch in an opinion of tremendous significance for the brokerage and investment management business. The Court held that tippers (whether or not they trade) and tippees (who sell in the open market on the basis of the inside information (there is also language in the opinion that would seem to support the possession theory - mere trading without disclosure of the inside information violates 10b-5 even though the inside information was not a factor in the investment decision)) are liable not just to their purchasers but to all persons who purchased in the open market without knowledge of the inside information. In addition the Court held that the Texas Gulf Sulphur standards are as applicable to a private damage action, as to an SEC injunction action and rejected any distinction between face-to-face transactions and open-market transactions. The Court left for later determination whether there should be a limitation on the extent of liability on the part of either the tipper or the tippees; if no such limit is found appropriate the tipper and/or tippees will be liable to all unknowledgeable traders for all of their losses no matter how small the transaction or "gain" by the tipper and/or tippees. When coupled with the SEC position in the Avis case that trading on a "bit" of information disclosed at a regular analyst meeting is in itself a 10b-5 violation, the Shapiro decision creates a risk factor that cannot be borne by brokers and investment managers under the present fee and profit structure of the securities industry.

Precautions against violation of the insider trading proscriptions should be reviewed and strengthened.

2. Rule 144; Written Records of Unsolicited Indications of Interest. The SEC has reversed its original position and now agrees that the written record of the unsolicited indication of interest necessay to support a broker contacting a customer to offer 144 securities need not have been made prior to receipt by the broker of the 144 sale order but may be made at or after the time the order is received. Salomon Bros., CCH ¶ 79,708 (Avail. Mar. 1, 1974)

3. Tender Offers; Unsoliciated Purchases by 30% Holder May be Tender Offer. The Staff of the SEC has retracted the position it took in American General Ins. Co. and has now refused to take a no-action position on a 30% holder increasing ownership to 50% through accepting unsolicited offers from time to time. LSL Corp., CCH ¶ 79,715 (Avail. Feb. 7, 1974). This may presage a change in attitude toward open-market purchases prior to a tender offer and open-market purchases that result in the accumulation of a large block -- perhaps 10% or more.

4. Rule 10b-5; Minority Shareholder Freezeout as a 10b-5 Violation. In Bryan v. Brock & Blevins Co., CCH ¶ 94,414 (5th Cir., Feb. 27, 1974) the Court avoided passing on the lower court holding that "going private" by creating a sister corporation and then doing a cash merger to eliminate the public minority constituted a 10b-5 violation by holding that the device violated the state law -- "general principles of corporation law."

5. Rule 10b-5; Plaintiff's Knowledge and Reliance. Mittendorf v. J.R. Williston & Beane, Inc., CCH ¶ 94,435 (S.D.N.Y., Mar. 11, 1974) says that the knowledge of the agent for buyer and seller, even though the agent is a partner of the seller, is imputable to the buyer so as to preclude reliance and therefore any violation of 10b-5, and that only the essence of a material fact, not the minute details, need be dislcosed to satisfy 10b-5. Interesting but questionable.

6. Rule 10b-5; Churning; § 20(a) does not Preempt Respondeat Superior Liability. Fey v. Walston & Co., CCH ¶ 94,437 (7th Cir. Mar. 14,1974) contains a good discussion of the basic principles applicable to a churning violation and holds that § 20(a) control person liability does not preempt respondeat superior liability.

7. Control; Participation Liability for Securities Law Violation. In one of the few judicial decisions interpreting "control" as used in the securities laws, the Fifth Circuit has held that a pledge to secure the unpaid portion of the purchase price for control shares sold and for which the buyers have the voting rights does not leave the seller in control.

The Court stressed that the buyers had a ten-day redemption period in the event of default. The Court also held that a mere pledge to secure unpaid purchase money does not, as such, make the unpaid seller a participant in the buyer's fraudulent sales of other securities of the issuer. Ayers v. Wolfinbarger, CCH ¶ 94,438 (5th Cir., Mar. 14, 1974).

8. Chinese Walls. The District Court has certified to the Second Circuit (which has not yet accepted the certification) the basic issue in Slade v. Shearson, Hammill & Co.: "Is an investment banker/securities broker who receives adverse material non-public information about an investment banking client precluded from soliciting customers for that client's securities on the basis of public information which (because of its possession of inside information) it knows to be false or misleading?" This is an issue of great importance to the securities, investment management and banking and trust businesses.

9. Market Information; Prospectus Disclosure of Potential 144 Sales. In Langert v. Q-1 Corp., CCH ¶ 94,445 (S.D.N.Y., Mar. 15, 1974) the Court holds that failure to disclose potential 144 sales may violate the 1933 Act and 1934 Act disclosure requirements.

10. Short-Swing Profits; Underwriters as 10% Holder. Perine v. William Norton & Co., CCH ¶ 94,447 (S.D.N.Y., Mar. 19, 1974) holds that an underwritter who has a greater than 10% participation and who is not exempted by Rule 16b-2 is nevertheless not an "insider" for 16b purposes on the ground that the statutory purpose does not require that an underwriter be considered a 16b-insider solely by virtue of an underwriting transaction.

11. Investment Advisers; Hedge Clauses in Advisory Contracts. In Auchincloss & Lawrence Inc., CCH ¶ 79,686 (Avail. Feb. 8, 1974) the Staff takes the position that a hedge clause which limits liability to "gross" or "willful" negligence violates § 206 of the Advisers Act. The Staff suggests that the following language be used:

> "Except for negligence or malfeasance, or violation of applicable law, neither you nor any of your officers, directors or employees shall be liable hereunder for any

action performed or omitted to be performed or for any errors of judgment in managing the Account. The federal securities laws impose liabilities under certain circumstances on persons who act in good faith, and therefore nothing herein shall in any way constitute a waiver or limitation of any rights which the undersigned may have under any federal securities laws."

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