To Our Clients

Recent Developments

1. Rule 10b-5; Inside Information; Merger Negotiations; Rejection of Possession Theory. In SEC v. Shapiro, CCH ¶ 94,494 (2d Cir. Apr. 9, 1974) the court held that an insider's (partner in a firm of finders) knowledge of merger discussions is material information even though the possibility of the merger is remote and the court impliedly rejected the possession theory and reiterated the requirement of causal connection between the information and the trading by finding and relying on such connection in the face of the SEC's argument that mere insider trading without disclosure establishes the violation.

2. Mutual Funds; Recapture of Commissions. Frankel v. Hyde, CCH ¶ 94,486 (S.D.N.Y., Apr. 4, 1974) says that a mutual fund management company may have a duty to recapture, that § 17(e) of the 1940 Act merely permits reasonable and customary commissions to a broker-affiliate of a management company and does not determine the question of recapture and approves the Budge testimony that portfolio commissions should be taken into account in determining the overall reasonableness of fund management compensation for purposes of § 36(b).

3. Pooling Accounting; Treasury Stock. In A.S.R. No. 146A the SEC has reiterated its position that treasury stock acquired within two years of a business combination, unless clearly acquired for a purpose other than use in acquisitions, destroys the pooling if it amounts to more than 10% of the shares issued in the business combination. The interpretation applies to business

combinations and treasury stock purchases subsequent to April 11, 1974. Treasury stock acquired for purposes other than acquisitions is not tainted for pooling purposes. The so called 75% guideline -- treasury stock acquired for warrant or option exercise when the market price is less than 75% of the exercise price is tainted -- has been slightly ameliorated by the SEC making it a presumption rather than a rule, with the company able to rebut the presumption on the basis of market volatility, life of options, earnings trends and similar factors.

4. Accounting; Effect of Inflation. The AICPA has recommended that the effects of inflation be shown as supplemental information in annual reports. The SEC previously called attention to the disclosure requirements with respect to the effect of inflation on inventory prices, profits and future profits. There is no question but that inflation is a material disclosure matter that requires careful handling in financial reporting. At the very least there should be a reference to the known general effects and the uncertainty of future effect.

5. Institutional Portfolio Disclosure. HR 13986 introduced by Representative Moss would require such portfolio transaction disclosures as the SEC prescribes for institutional investors managing more than $100 million (subject to reduction by the SEC to $10 million). Included as institutional investors in addition to insurance companies, banks, investment advisors, employee benefit plans and investment companies would be brokers and "any person, other than a natural person, investing in or buying and selling securities for its own account."

6. SEC Filings. The SEC has adopted, effective June 3, 1974, Rule 12b-25 providing that all applications for extension of time to file reports required under

the 1934 Act must be made on Form 12b-25 which requires specific details as to why the filing cannot be made on time and a showing why the extension is consistent with the public interest and the protection of investors. Two extensions of up to 30 days each are provided for. The first is automatic on the filing of Form 12b-25 unless within 15 days after filing the SEC denies the application; the second is deemed denied unless within 15 days after filing the SEC grants the application. Rule 0-3, effective immediately postpones filing due dates falling on weekends or holidays to the next business day.

7. Institutional Access; Nonmember Discount. The SEC has rejected the NYSE amendment to its Rule 385 which would have made the definition of affiliated person more stringent for nonmember access than for "public" business of a member. However, the SEC pointed out that the NYSE has not adopted all the flexibility intended to be provided by Rule 19b-2 and has invited the NYSE to determine whether a nonmember broker is really a "captive" on a case by case basis.

8. Rule 10b-5; Disclosure to Knowledgeable Party; Participation Liability of Corporate Officers as Aiders and Abettors and Control Persons. SEC v. Coffey, CCH ¶ 94,464 (6th Cir., Mar. 28, 1974) takes a considerably more restrictive view of 10b-5 liability than many of the recent circuit court cases and while not the law in the more expansive circuits, is an interesting precedent on which to argue the other way. The Court held:

(1) The SEC is not entitled to an injunction against a corporate officer on the basis of a violation by his corporation; the officer must have been a participant or an aider and abettor.

(2) There is no 17(a) or 10b-5 duty to disclose information to a party who reasonably should be aware of it.

(3) Mere negligence will not suffice to establish a 10b-5 violation in an SEC injunction action;

"willful or reckless disregard of the truth" is the requisite standard.

(4) Corporate officers do not have the duty to carefully supervise agents placing securities for the corporation and a Chairman of the Board does not have such a duty with respect to the Financial Vice President.

(5) One must "knowingly and substantially" assist the violation to be an aider and abettor; inaction may be a form of assistance only where silence was consciously intended to aid the violation.

(6) The SEC may not rely on control person liability under § 20(a) in an injunction case; § 20(a) applies only in civil liability cases; the SEC must rely on § 20(b) in an injunction case and as provided in § 20(b) show knowing use of the controlled person to violate the securities law.

9. Suitability; Market-Makers Duty to Know Securities Traded and to Quote Prices Based on "Value". A market-maker violates 17(a) and 10b-5 when it trades and quotes a security at prices not related to the activities of the company. SEC v. Management Dynamics, Inc., CCH ¶ 94,468 (S.D.N.Y., Apr. 1, 1974).

10. Rule 10b-5; Disclosure of Principal Transactions by Broker-Advisor. In Cant v. A. G. Becker & Co., (N.D. Ill. Mar. 28, 1974) the Court held that the customary code disclosure on a confirmation does not satisfy a broker-advisor's duty to disclose principal transactions to a customer who was trusting and heavily reliant on the broker-advisor.

11. Rule 144; Sales by Pension Trust. An issuer's pension trust of which the issuer's president is trustee can avail itself of Rule 144, but any sales by officers or directors of the issuer would be aggregated with the sales by the pension trust for 144 purposes. Equity Oil Co., 247 S.R.L.R. C-1 (Avail. Mar. 29, 1974).

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