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TO OUR CLIENTS

Recent Developments

1. Commercial Paper; Dealer's Suitability Investigation Requirements. The consent decree entered into by Goldman, Sachs & Co. in the Penn Central matter, SEC v. Goldman, Sachs & Co., CCH ¶ 94,556 (S.D.N.Y. No. 74-1916, May 2, 1974), sets forth the procedure to be followed by Goldman, Sachs with respect to commercial paper it deals in as dealer or broker:

1. Prior to handling commercial paper of an issuer not previously handled, G-S will do a corporate legality check, determine that 1933 Act registration is not required for the commercial paper (current transaction test is met) and conduct an investigation supporting reasonable grounds to believe the issuer has the ability to pay the commercial paper as it matures.

2. G-S will obtain the issuer's agreement to supply, or if unable to obtain such agreement G-S will use its best efforts to obtain, periodic reports from the issuer to enable G-S to evaluate the commercial paper and, after the exercise of reasonable care, G-S as a condition to handling the commercial paper must conclude that there is no reason to believe that the issuer will be unable to pay its commercial paper as it matures.

3. G-S will (unless waived by the buyer) deliver the suitability information to buyers of the commercial paper at or before the delivery of the commercial paper. In essence this is a prospectus (albeit not filed under the 1933 Act) requirement for commercial paper.

All broker-dealers in commercial paper, and other exempt securities, while in no way bound to follow these guidelines, would be well advised to follow substantially the same procedures. Failure to follow these procedures will, in the event of an issuer default, increase the probability of a broker-dealer being held to have violated the federal securities laws or to have been guilty of common law negligence.

2. Notes and Debentures; Requirement of Specific Reference to "No-Action" Provision. In Friedman v. Airlift International, Inc., N.Y.L.J. May 28, 1974, p. 3 col. 1 (N.Y. App. Div. 1st Dept. May 24, 1974) the Court, with one judge dissenting, held that failure to refer specifically to the "no-action" provision (standard boilerplate limitation on the right of individual bondholder to sue unless the indenture trustee has failed to sue after demand by holders of 25% of the principal amount of the bonds) of the indenture on the bond itself renders the no-action provision ineffective despite numerous incorporating references on the bond to the indenture. The Court said that if the no-action limitation on the obligation to pay had appeared on the bond, it would have made the bond non-negotiable. As the dissent points out the majority appears to be confusing commercial paper with investment securities. Article 8 of the UCC provides that limitations on the face of a certificate for an investment security do not impair negotiability. While the majority opinion appears to be wrong on both questions, the holding has such wide and important application that it cannot be ignored. To the extent that one does not draft around the decision, there is a new disclosure requirement.

3. Tender Offers; Open Market Purchases by Management of Target to Defeat a Tender Offer Violate the Williams Act. Orbanco, Inc. v. Security Bank, CCH ¶ 94,559 (D. Ore. Feb. 1, 1974) appears to hold that purchases by management of a target company made to defeat a tender offer must comply with Rule 13e-1 which literally refers only to purchases by the target itself.

4. Form S-7. General Instruction A(f) requiring that dividends for the past five years have been "earned" means earnings after taxes. International Proteins Corp., CCH 74,790 (Avail. Apr. 29, 1974).

5. Rule 144; Divorce Settlement; Tacking and Aggregation. The holding period for restricted securities transferred to a wife in a divorce settlement may be tacked to that of the husband and no aggregation of sales by husband and former wife is required. Dolman, Kaplan, Neiter & Hart, CCH ¶ 79,789 (Avail. Apr. 29, 2974).

6. Definition of a Security; Notes; Economic Realities Test. Davis v. Avco Corp., CCH ¶ 94,560 (N.D. Ohio Jan. 11, 1974) applies the economic realities test to notes issued to pay for franchises and holds such notes to be securities within the federal securities laws.

7. Definition of a Security; Franchise Agreements. Bitter v. Hoby's International, Inc., CCH ¶ 94,562 (9th Cir. May 8, 1971) is a very significant opinion limiting the holding in SEC v. Glenn W. Turner Enterprises, 474 F.2d 476 (9th Cir. 1973) that a franchise is a security -- if the efforts of those other than the investor are significant to success or failure -- to cases where the success of the investment depends primarily on the efforts of the promotor or someone other than the investor -- thus the Court drew the line short of the typical restaurant franchise (even one where the selling brochure emphasizes the option to operate through a hired manager so that the investment is passive) following the 10th Cir. in Mr. Steak and the S.D.N.Y. in Wieboldt v. Metz. The 9th Cir. also refused to follow the California view that a franchise -- not otherwise a security -- issued by an inadequately capitalized franchisor is a security.

8. Investment Company Act; Implied Rights of Action; Change of Control; Compliance with § 14(f). Monheit v. Carter, CCH ¶ 94,564 (S.D.N.Y. May 16, 1974), on a motion to dismiss the complaint, holds that violations of §§ 17(d) and 35(d) of the 1940 Act give rise to private rights of action and that where sufficient existing directors switch allegiance to give control to a person who has acquired stock in a transaction subject to § 13(d) or § 14(d) then § 14(f) applies.

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