To Our Clients:

Recent Developments

1. Going Private; Minority Shareholder Freezeout. Grimes v. Donaldson, Lufkin & Jenrette, Inc., CCH ¶ 94,722 (N.D. Fla., July 15, 1974) is the classic case of a cash tender offer to acquire control followed by a cash merger to eliminate the remaining shareholders. The court holds that where full disclosure was made in the tender offer, there is a business purpose for the merger and the remaining shareholders receive a fair price, there is no basis under the federal securities laws or Delaware corporation law to interfere with the merger. The court found appropriate business purposes for the merger in that both companies were in similar businesses, the merger would eliminate corporate opportunity and other conflicts between the control shareholder and the minority and that the merger would result in administrative expense savings. The court found fairness--even though the merger price was about 50% of book value--on the basis of an evaluation of a "fair and equitable price" for the minority shares on a continuing concern basis by an independent investment banker. The court distinguished Bryan v. Brock & Blevins Co., 490 F.2d 563 (5th Cir. 1974) on the ground that in Bryan four of the five shareholders of a close corporation used the cash merger device to freeze out the fifth shareholder in a case where there was no business purpose other than the freezeout.

2. "Security" - Definition; Discretionary Accounts; Short-Term Notes. In SEC v. Continental Commodities Corp., CCH ¶ 94,724 (5th Cir., July 17, 1974), the court rejected the holding of the Seventh Circuit in Milnarik v. M-S Commodities, 457 F.2d 274, cert. denied 409 U.S. 887 (1972), and found a discretionary commodity option brokerage account managed on an individual and not a pooled basis to be a security. This holding again raises the question as to the status of the typical discretionary securities brokerage account. The SEC continues to accept the individual versus pooled management dichotomy. However, there is growing danger that the courts will not accept this distinction and the discretionary account that has suffered losses will have an

absolute right of rescission against the broker. The Continental Commodities case is another holding to the effect that the short-term note exception to the 1933 Act and 1934 Act definitions of a security is to be determined on the basis of whether the note has a commercial or investment character--a test which limits the exception essentially to bank loans, prime commercial paper and "normal" commercial dealings. McClure v. First National Bank, CCH ¶ 94,737 (5th Cir., July 22, 1974) and Crowell v. The Pittsburgh & L.E. R.R., CCH ¶ 94,731 (E.D. Pa., Mar. 8, 1974) are similar holdings on the issue of notes as securities. The McClure case applies the investment-commercial test to a long-term note and holds that a long-term note issued in a commercial (typical bank loan) transaction is not a security.

3. Brokers; Disclosure of Principal Transactions. Cant v. A.G. Becker & Co., CCH ¶ 94,747 (N.D. Ill., Mar. 29, 1974) previously noted in these memoranda deserves reiteration. The court held that the customary confirmation disclosure of a principal transaction was not sufficient in the case of a customer who was relying on the broker for advice--the court said that the disclosure should have been made at the time of the conversation that resulted in the transaction. Brokers should reexamine their procedures as to disclosure of market-making and inventory positions in all written communications to customers, strengthen instructions to salesmen and order room personnel to make such disclosures when soliciting orders from retail customers and revise their confirmation forms to more fully disclose principal and market-maker transactions, i.e., "In this transaction we did not act as your agent, but rather as a principal for our own account and the price to you determined whether we made a profit or loss on the transaction."

4. Tender Offers; Injunctive Relief for Williams Act Violations. Mosinee Paper Corp. v. Rondeau, CCH ¶ 94,719 (7th Cir., July 16, 1974) holds that failure to timely file under § 13(d) is more than a mere technical violation and at the instance of the target company may be "punished" with an injunction. "[The target company] need not show irreparable harm . . . in view of the fact that . . . it is in the best position to assure that the filing requirements of the Williams Act are being timely and fully complied with and to obtain speedy and forceful remedial action when necessary." The court also holds that § 13(d) is

designed not just to alert to change of control but also to the existence of a holding that protends the potential for effectuating a change of control.

5. "Security" - Definition; Pyramid Distributorships; Franchises. The Fifth Circuit has joined the Ninth Circuit in interpreting the "solely from the efforts of the promoter" language of the Howey case on a functional rather than literal basis so that even though the investor has some managerial responsibility the franchise or other investment plan will be considered a security if the essential managerial efforts which affect the success of the enterprise rest with the sponsor. SEC v. Koscot Interplanetary, Inc., CCH ¶ 94,710 (5th Cir., July 15, 1974).

6. Disclosure of Estimates and Opinions. Opinions, clearly disclosed as such, even if erroneous, do not violate the disclosure requirements of the Williams Act. ICM Realty v. Cabot, Cabot & Forbes Land Trust, CCH ¶ 94,709 (S.D.N.Y., July 12, 1974).

M. Lipton