TO THE TRUSTEES OF THE UNIVERSITY OF PENNSYLVANIA:

We have been asked as University Counsel, whether the manner in which the investment banking firm of Butcher & Sherrerd disposed of the University's holdings of stock of the Penn Central Company in May of this year violated any statutes or stock exchange rules relating to the preferring of investment advisory customers over the accounts of the advisory firm or those closely associated with it.

In addition to our conversation with Mr. William L. Day, Chairman of the Trustees, we have talked briefly with representatives of Butcher & Sherrerd, with various officers and employees working in the Treasurer's Office and Investment Office of the University, and with George Connell, the officer of Drexel Harriman Ripley, Incorporated, who is in charge of that firm's activities in connection with the University's account. We have seen some of the underlying documentation relating to the brokerage transactions in question, but we have not made a thorough or exhaustive study of the various sales slips and journal entries involved, nor have we attempted to authenticate or supplement in detail the facts as described to us in the brief meetings we have had with the persons indicated above.

Under the Investment Advisers Act, to which Butcher & Sherrerd is subject, the duties of the adviser to its customers are broadly stated. The duty of an investment adviser under Section 206 was recently discussed by the Securities and Exchange Commission in the matter of Kidder Peabody & Co., et al, Securities Exchange Act Release No. 8426, Investment Advisers Act Release No. 232, handed down on October 16, 1968. In that case, the Commission accepted an offer of settlement in which it censured Kidder Peabody & Co., Inc. and one of its officers. The Kidder Peabody firm admitted that its officer and some of his relatives had purchased or sold securities before they were purchased or sold for other unrelated advisory clients at prices which were more favorable than the prices paid or received for the same securities by such unrelated clients. The SEC's interpretation of the requirements of the Investment Advisers Act may not be fully upheld in any private litigation involving a similar issue, but there can be no doubt that the Commission's views will be of importance to any court required to decide the proper scope of an investment adviser's duty.

In the close of its opinion, the SEC summed up the applicable legal principles as follows:

"One of the basic duties of a fiduciary is the duty to execute securities transactions for clients in such a manner that the client's total cost or proceeds in each transaction is the most favorable under the circumstances, cf., Thompson and McKinnon, Securities Exchange Act Release No. 8310 (May 8, 1966); Ariene W. Hughes, supra. This duty encompasses..."
The Advisers Act was aimed at eliminating conflicts of interest between an investment adviser and his clients. Consequently, an investment adviser must not effect transactions in which he has a personal interest in a manner that could result in preferring his own interest to that of his advisory clients. Furthermore, whenever trading by an investment adviser raises the possibility of a potential conflict with the interests of his advisory clients, the investment adviser has an affirmative obligation to obtain the informed consent of his clients on the basis of full and fair disclosure of all material facts. Full disclosure of such potential conflict must be made to apprise the client of relevant facts so that the client is able to give his informed consent to transactions executed for the client, or to reject such transactions if he so desires. See, Securities and Exchange Commission v. Capital Gains Research Bureau, Inc., 375 U. S. 180 (1963); Arlene W. Hughes, supra.

We understand that in March 1970, the University in accordance with a general determination made by its Investment Committee, began a gradual reduction of its Penn Central holdings. Butcher & Sherrerd sold for the University's account between March 5 and April 1, an aggregate of 18,500 shares. It was not, however, until May 15 that a definite selling program for the disposition of its remaining 94,714 shares was decided upon and undertaken. We have been advised that during the week of May 18, a substantial number of shares were sold by Butcher & Sherrerd for its own account and for the account of various partners and members of their families, and that most of such shares were sold toward the end of the week. The question, therefore, is whether these sales violated the rules stated above in the Kidder Peabody proceeding.

With respect to the sales by the University on and after May 15, we understand that as a result of a conversation between Mr. Butcher and Mr. Connell of Drexel Harriman Ripley, Incorporated, on May 15, 1970, Drexel Harriman Ripley, Incorporated has given general instructions to sell an aggregate of 42,607 shares of Penn Central. A specific order was marked for sales at $15-3/8, approximately the prevailing market, and 3,000 shares were sold at that price.

On May 18, the next trading day, Drexel Harriman Ripley, Inc. sold an additional 2,000 shares at $15-5/8. Butcher & Sherrerd came upon an opportunity to sell an additional 3,000 at $15-1/2, and after checking with Drexel, effected this transaction as a part of the sale instruction for 42,607 shares given Drexel as described above. The market price of the stock declined below $15 on Tuesday and Wednesday, May 19 and 20, and accordingly no shares were sold in accordance with the sales orders at that general level which remained in effect at Drexel Harriman Ripley.

In view of the decline in market price and the failure to effect sales at the $15 level, Drexel Harriman Ripley reduced the sale price on Thursday, May 21, to $13-1/4. 100 shares were sold at that price, and an additional 10,000 shares were sold later that day when the Drexel trading department reduced the asking price to $13 flat.

On Friday, May 22, when the market price dropped almost two points, Drexel Harriman Ripley entered sale orders "at market" for the remaining portion of its 42,607 sales order and sold all of the University's remaining shares at prices ranging from $11-1/4 to $11-7/8, except for 40,000 shares which Butcher & Sherrerd, on receipt of an order on the Philadelphia Exchange, and after checking with Mr. Connell, sold at $12 per share.

SECRETARY
It can be seen from the foregoing that if Butcher & Sherrerd, as the University's investment adviser, should be considered responsible for the manner and timing of all sales for the University's account, and if the rules enunciated in Kidder Peabody are carried to their logical extreme, namely, that an investment adviser may make no sales for his account until he has completed all of the sales he has recommended to all of his advisory clients, some or all of the sales made by Butcher & Sherrerd during the week of May 18 for its own account and for the account of affiliates, as referred to above, may be held to violate those rules. We should point out, however, that there is not the slightest indication of any bad faith or conscious wrongdoing on the part of Butcher & Sherrerd. During the period involved, Butcher & Sherrerd had no outstanding order for the sale of the University's Penn Central stock, and whatever sales may have been effected by the Butcher firm were part of large scale trading for its many customers, conducted under circumstances where elaborate and meticulous cross-checking of priorities and customer preference was, as a practical matter, an impossibility. In addition, we would think it difficult to establish that these sales in fact damages the University, i.e., to prove that the latter would have obtained a higher price if the sales had not been put through. It is possible that before any claim for damages could be sustained, a specific showing of this type might be necessary.

Under all of the circumstances, it is our opinion that while the facts may sustain a finding that Butcher & Sherrerd, during the week of May 18, committed an inadvertent violation of the rules enunciated by the SEC for investment advisers, and while it is possible, though by no means certain, that a court might sustain a literal application of the rules without regard to the practicalities or the equities of the situation, the violation, if any, was committed in good faith and the loss caused to the University is not substantial in relation to the amounts involved. As we have advised you in the past, the Trustees have no legal obligation to test in court every possible cause of action no matter how doubtful and regardless of whether any substantial damages are involved. We believe that that is the type of situation which is here presented.

Yours very truly,

JAB: DHCP

November 12, 1970

TO THE TRUSTEES OF THE UNIVERSITY OF PENNSYLVANIA:

In response to the comments made by members of the Investment Committee at its meeting Monday, November 9, with respect to our opinion of November 5 relating to sales by Butcher & Sherrerd of Penn Central stock in May of this year, we are writing to supplement that opinion.

Some members of the Committee asked me to determine the difference between the average price at which the Butcher & Sherrerd firm, its partners or their spouses sold shares between May 15 and May 22 and the average price at which shares were sold for the University's account during the same period. I have been advised by Mr. Butcher that the average price for sales for such accounts by Butcher & Sherrerd was $13, as compared with $12.23 for the University's shares -- a difference of 77¢ a share.

Committee members were concerned about the possible application of rules of the New York Stock Exchange to the situation discussed in our opinion of November 5, in which we quoted the closing paragraphs of the opinion of the SEC in the Kidder Peabody
Executive Board, November 13, 1970

proceeding as setting forth the required standards of conduct. The applicable NYSE Rule, Rule 92, prohibits the sale of a security on the Exchange for the account of a member firm or a participant in the firm at any time that the members holds a market order or has knowledge that his firm or any participant therein holds a market order to sell the same security for a customer. With respect to limited price orders, sales are similarly prohibited at any price at or above the price of a limited price order held for a customer.

This rule does not appear to be as all inclusive or as strict as the required standards of conduct promulgated in the Kidder Peabody opinion of the SEC. Since Butcher and Sherrerd did not hold an order from the University to sell Penn Central stock between May 15 and May 22, there would not appear to be even a technical violation by Butcher & Sherrerd of Rule 92. Furthermore, sales effected by Butcher & Sherrerd for its own account, its principals, or in the account of participants in the firm on Tuesday and Wednesday, May 16 and 17, were effected at prices lower than the limited price order than held by Drexel Harriman Ripley, Incorporated. On May 22, Butcher & Sherrerd did execute one transaction at $12 for the account of the University on the Philadelphia-Baltimore-Washington Stock Exchange, which has a rule (452) identical to NYSE Rule 92. We are advised, however, that this transaction was not the result of a previously existing sale order placed with Butcher & Sherrerd, but rather occurred when Mr. Butcher, noting the availability of the bid on the P-B-W Exchange, checked to see whether the University still had 40,000 unsold shares and effected the transaction immediately.

Counsel for Butcher & Sherrerd have maintained vigorously that the firm's actions do not violate these Stock Exchange rules, and on the basis of the facts developed to date, we believe there is merit in that position.

Yours very truly

DRINKER BIDDLE & REATH

JAB:th

APPENDIX E

TO: President Martin Meyerson
FROM: John C. Hetherston
DATE: October 27, 1970
SUBJECT: Background information regarding 3:00 p.m. meeting on Thursday, October 29, 1970

Anticipated Attendance: President Meyerson, Mr. Freedman, Mr. Hetherston, Dr. Hobstetter, Mr. Manley, Mr. Sweeten

There will be several interrelated matters presented. The fundamental decisions which need to be made are as follows:

1. Shall we attempt to switch a "gift" to the Graduate Center from that project to what will eventually be "free funds?"

2. Would we be willing to name one of the towers in the graduate housing area for the donor in recognition of the change in purpose of the gift?

3. Should we at this time conclude that the proposed means of financing the Graduate Center is unrealistic and that the