ADMINISTRATIVE PROCEEDING
FILE NO. 3-7900

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	)
COUNSELLORS TANDEM SECURITIES FUND, INC.	)
SEQUOIA PARTNERS, L.P.	)

INITIAL DECISION

Washington, D.C.
July ~~13~~ 14, 1993

Edward J. Kuhlmann
Administrative Law Judge

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APPEARANCES: Elizabeth G. Osterman, Susan Ferris Wyderko, and Maura A. Murphy for the Division of Investment Management

Jeanne M. Luboja for Counsellors Tandem Securities Fund, Inc.

Victor M. Rosenzweig and Thomas J. Fleming for Sequoia Partners, L.P.

BEFORE: Edward J. Kuhlmann, Administrative Law Judge

Sequoia Partners, L.P., a limited partnership, and Counsellors Tandem Securities Fund, Inc. have submitted an Application pursuant to §17(d) of the Investment Company Act of 1940, 15 U.S.C. 80a-17(d), and Rule 17d-1 thereunder, 17 C.F.R. 270.17d-1, for an Order allowing the Fund to reimburse Sequoia for proxy expenses incurred in a challenge to the Fund's management. Section 17(d) and Rule 17d-1 require prior Commission approval before a fund and an affiliated entity such as Sequoia may enter into a joint transaction. In reviewing transactions under §17(d), the Commission must determine whether the transaction is consistent with the purposes and policies of the Investment Company Act. The following issues will be considered in this decision:

1. Whether the Commission should deny an application under section 17(d) and rule 17d-1 as untimely because, notwithstanding the requirement of Rule 17d-1 that the Commission issue an order permitting any joint transaction before it is effected, applicants have engaged substantially in a joint transaction.

2. With respect to the merits of the application,

   a. whether the Fund's participation in the joint transaction on the basis proposed is consistent with the provisions, policies and purposes of the Act; and,
   b. whether such participation is on a basis different from or less advantageous than that of other participants.

FINDINGS OF FACT

Counsellors Tandem Securities Fund, Inc. (the Fund) is a closed-end management investment company registered under the Investment Company Act of 1940 (the Act). (Applicant Ex. U at 7) The Fund's objective is to achieve long term capital appreciation. (Applicant Ex. U) The Fund invests in a portfolio of utility

stocks which are managed by a subsidiary of E.M. Warburg Pincus & Co. of New York, Warburg, Pincus Counsellors, Inc. Three of the seven directors of the Fund are elected by the holders of preferred stock and four directors are elected by the preferred and common stockholders voting together. (Tr. 11, 14, 106; Applicant Exs. U, V, G) Three directors are employees of Warburg, Pincus. In April 1990, the Fund, whose shares are traded on the New York Stock Exchange, had outstanding approximately 4.85 million shares of common stock and 880,000 shares preferred stock. (Tr. 10; Applicant Ex. G at 2)

The Fund's preferred stock receives a fixed annual dividend of 7.25 percent; it matures on October 30, 1996 at a liquidation value of $50 per share. (Tr. 11; Applicant Ex. V at 9-10. From 1989 through April 1990, the Fund's assets ranged from $85 million to $101.7 million. (Applicant Ex. O at 9, Ex. V at 11) Throughout 1989, the Fund's common stock traded at a discount from net asset value in a range of approximately 17 percent to 24 percent. 1/ (Tr. 12; Applicant Ex. T)

Sequoia Partners, L.P. (Sequoia), a limited partnership whose general partner is Timothy P. Hurley, invests in closed-end investment funds which trade at a discount to net asset value. (Tr. 9-10; Applicant Ex. R at 4) Hurley testified that he had found

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1/ The net asset value per share of a closed-end investment company is calculated by deducting the value of the preferred securities from the total net assets and the dividing the balance by the total number of common shares outstanding. Because prices for closed-end fund shares are set by market forces, the common stock does not necessarily trade at net asset value.

that in the first quarter after closed-end investment companies were established the stock sells at a discount to net asset value of 20 to 25 percent. (Tr.9) He explained that the discount presented an investment "opportunity" for Sequoia to acquire a block of stock at the discount and then seek to have the management make changes which result in the shares selling at full asset value or more. (Tr. 9, 68)

Sequoia had purchased 10 percent or 485,000 shares of the Fund's common stock by February 1990. (Applicant Ex. F at 1) On July 24, 1989, Sequoia filed with the Commission a Schedule 13D in which it disclosed that it had acquired beneficial ownership of 420,000 or 8.7 percent of the Fund's common stock and had become an "affiliated person" of the Fund. (Applicant Ex. R; 15 U.S.C. §80a-2(a)(3)) Sequoia informed the Commission in the Schedule 13D that it intended to negotiate with the Fund to reduce the discount at which the Fund was trading by either liquidating the Fund or causing it to convert to open-end status. 2/ (Applicant Ex. R at 4)

On August 14, 1989, Sequoia amended Schedule 13D which disclosed understandings with shareholders of the Fund, South Pacific Land Investments Corporation, Morly Financing Inc. and Sierra Trading to acquire shares and obtain net asset value or more

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2/ Open-end fund securities are redeemable at net asset value and, therefore, when a closed-end fund converts to open-end, stockholders have an opportunity to realize an immediate profit, equal to the difference between the discounted purchase price and the net asset value per share. If the fund liquidates, the liquidation proceeds are equal to the net asset value per share.

for their shares. (Div. Ex. 1; Tr. 12-15) These entities, including Sequoia and Delta Management Group, L.P., formed a 13D Group. Delta, which is principally engaged in providing management and consulting services, has the power to vote the shares acquired by the members of the 13D Group. (Div. Ex. 1; Applicant Ex. R.)

Timothy Hurley is the general partner of Sequoia, President of Delta and the President, director, and only stockholder of Hurley Holdings, Inc., which is the general partner of Delta. (Div. Ex. 1; Applicant Ex. F) In August 1989, Sequoia, South Pacific, and Delta beneficially owned 10 percent of the outstanding common shares of the Fund. Delta assisted other members of the Sequoia Group in the purchasing the Fund's common shares and, in return, Sequoia and Delta share in the group members' profits made from selling the shares. (Applicant Exs. F, S) By early 1990, the Sequoia Group owned 25.5 percent of the Fund's outstanding common shares and 0.2 percent of the preferred shares. (Applicant Ex. F)

In August 1989, Sequoia met with the Fund to see if the Fund would take steps to reduce or eliminate the discount at which the Sequoia group had purchased their shares. (Applicant Ex. X at ¶ 6) The Fund rejected these overtures. On February 8, 1990, the Fund announced its plans to hold a combined annual and special meeting of the shareholders on April 10, 1990 to elect directors and to consider two non-binding proposals relating to changing to an

open-end fund or liquidating the Fund. (Applicant Ex. G, Ex. F at 6; Tr. 16-17) On February 12, 1990, Sequoia announced its intention to nominate directors who favored making the Fund open-ended or liquidating the Fund. Sequoia nominated its slate of directors in a letter to the Fund dated February 16, 1990. In early March 1990, the Fund rejected a proposal by Sequoia to call off the proxy contest in exchange for certain concessions from the Fund. (Applicant Ex. E) On March 8, 1990, Sequoia distributed proxy solicitation materials to the Fund's shareholders. (Applicant Exs. C and F; Tr. 19)

Sequoia announced that its nominees, if elected, would call a special meeting of shareholders at the earliest practicable date to submit to the Fund's shareholders binding proposals to liquidate or change the Fund to an open-end investment company. (Tr. at 20; Applicant C, F at 3-5) Sequoia announced that it did not intend to replace the Fund's investment advisor, Warburg, Pincus Counsellors Inc., or seek the advisory contract itself. (Tr. 15, 21; Applicant Ex. F at 4) Sequoia also solicited proxies in favor of the precatory proposals submitted by the Fund, but took the position that a majority, not two-thirds, of the shareholders could approve converting to an open-end fund. (Tr. 22-30; Applicant Ex. F at 4)

On March 10, 1990, the Fund mailed to all shareholders a Notice of Combined Annual and Special Meeting of Stockholders to be held on April 10, 1990. The Fund also mailed to shareholders its materials soliciting proxies for its slate of directors and

recommending that the holder of common stock vote against the two non-binding proposals. (Tr. 23; Applicant Ex. G) During the proxy contest, Sequoia and the Fund addressed whether the Fund should liquidate or convert to an open-end investment company. (Tr. 22-30; Applicant Exs. H-K)

Sequoia and the Fund hired proxy solicitors and law firms in New York and Maryland to provide professional assistance in the proxy contest. (Tr. 106-09; Applicant Ex. Q) By early April, both parties believed that the preferred shareholders would elect the three Sequoia nominees and that the contest for the other four directors to be elected by the preferred and common shareholders voting together was too close to call. (Tr.30-1, 107) The election could have resulted in a board nearly split between Sequoia and the Fund's nominees. The result might have been to continue the battle over whether to liquidate or make the Fund an open-end fund. The continued fight, the parties believed, would have been expensive for both sides. (Tr. 30-1, 50-1)

In early April 1990, the Fund and Sequoia began to negotiate a settlement. (Tr. 31-2; Division Ex. 7) An agreement was reached on April 5, 1990, five days before the annual meeting which would elect the directors. The settlement agreement provided that Sequoia would not continue the proxy contest, the Fund would make an all-cash tender offer for up to a two million common shares, or approximately 41 percent of the common shares, and the Fund would reimburse Sequoia for up to $240,000 of its proxy expenses. (Applicant Ex. L) (Sequoia's direct out-of-pocket expenses in

connection with the proxy contest and in the negotiation of the settlement agreement were $316,888.) The Fund also made an all cash tender offer for about 34 percent of the preferred shares (303,030) at $49.50. The Fund agreed to call a special shareholders meeting to vote on a binding proposal to liquidate the Fund if more than 51.1 percent of the common shares were tendered. The Fund's board unanimously approved the settlement agreement and, on April 5, 1990, the agreement was signed by Sequoia and the Fund. (Applicant Ex. L)

The parties discussed two payment plans during their negotiations. One would have paid a tender offer price equal to 94 percent of net asset value with an additional $300,000 to be paid to Sequoia for reimbursement of its expenses. The other would have paid a tender offer price of 95 percent of net asset value with a $240,000 payment (plus any interest earned) to Sequoia for expenses. (Tr. 78-80, 91; Applicant Ex. X at ¶ 20) Both payment plans would have resulted in Sequoia receiving nearly 100 percent of net asset value per share. Other shareholders who tendered their shares would have received only 95 percent of net asset value. (Tr. 78-82, 85-93; Applicant Ex. X at ¶ 20; Division Exs. 2,3,4,5)

The tender offer exceeded the trading price of the common stock. (Applicant Exs. O,P) About 46 percent of the common stock shares (approximately 2.247 million shares) were tendered and 89 percent of the preferred shares. (Tr. 41-2, 47; Applicant Exs. O, P) The 13D Group tendered 1.24 million common shares and 1600 preferred shares. The shareholders were informed about the payment

of $240,000 to Sequoia. (Tr. 137) The Fund began the tender offer on April 13, 1990. While the Board of the Fund unanimously approved the agreement, they all recommended that common stockholders reject the offer and not tender their shares. The Board told the stockholders that they had structured the tender offer to increase the net asset value of the common stock not tendered.

The agreement between Sequoia and the Fund provided that the $240,000 be placed in an escrow fund pending a Commission ruling on the application at issue in this case. (Applicant Exs. L, M, W) The Fund took the $240,000 out of its portfolio on April 2, 1990, and put it in the escrow account. The removal of $240,000 from the Fund's investment pool decreased the net asset value per share by five cents. (Tr. 49, 75, 125, 137) It affected the value of all shares because the Fund segregated the $240,000 before calculating the tender offer price for the common stock. (Tr. 137)

The Fund and Sequoia filed an application with the Division of Investment Management seeking approval of the payment to Sequoia on May 1, 1990. It was filed 12 days after the Fund had accrued the expense for the payment to Sequoia and nine days before the tender offer closed on May 10, 1990. (Applicant Ass. M, P, W) Because 15 days public notification is required under the Federal Register Act, the Commission could not have issued an order before the tender price was set on May 7, 1990, nor could it have done so before the tender offer closed on May 10, 1990. (44 U.S.C. §1508; Applicant Ex. M, P) The settlement contemplates that the

segregated $240,000, together with any interest earned on it, will be transferred from the escrow account to Sequoia as soon as the Fund obtains an order from the Commission approving the reimbursement provision. (Applicant Ass. L at ¶ 5(b), M, O at 19)

CONCLUSIONS

The Joint Transaction Violates the Investment Company Act and Rules

Sequoia and its 13D Group entered into an agreement with the Fund for reimbursement of $240,000 of the group's expenses in pursuing a proxy contest and negotiating the settlement agreement. That amount when added to the price the 13D Group received for its shares results in a payment to the 13D Group of approximately 100 percent of the net asset value of its tendered shares. 3/ Those stockholders who did not belong to the 13D Group will receive only 95 percent of net asset value for their tendered shares.

Under Section 17(d) and Rule 17(d)-1, the Commission must "consider whether the participation of [the investment company] in such joint enterprise ... on the basis proposed is consistent with provisions, policies and purposes of the [Investment Company] Act

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3/ Sequoia argues that it is incorrect to characterize the $240,000 payment as approximately 100 percent of the net asset value of its shares since not all of its tendered stock was purchased by the Fund when the tender offer was oversubscribed. Apparently that was the case, but the record reflects that that was not the intention of the parties. Sequoia explains in its brief that if the Fund had not agreed to pay its expenses, it would have insisted on full net asset value for the shares tendered. Moreover, both schemes considered by Sequoia and the Fund to resolve the proxy fight used a percentage of net asset value for the shares tendered and a payment to Sequoia for its expenses that amounted to approximately 100 percent of net asset value. Of course, Sequoia will actually receive more than the net asset value for its tendered shares with the reimbursement.

and the extent to which such participation is on a basis different from or less advantageous than that of other participants." The Division argues that while the other shareholders may have received collateral benefits and the decision of the Fund's board may have been based on sound business reasons and in the best interests of the fund, the Commission is required to independently review joint transactions to determine whether they are fair. Under 17(d), the Division points out, deference is paid to the board's determination but other factors must be considered such as whether the determination of the board was influenced by shareholders who own large blocks of the fund's securities, or whether the board was subject to a conflict arising from the interests of the fund's directors. See, e.g., Tyler Cabot Mortgage Securities Funds, Inc., Investment Company Rel. Nos. 19072 (Nov. 2, 1992) (notice) (52 SEC Dkt. 3608, 3620) and 19134 (Dec. 1, 1992) (order) (52 SEC Dkt. 4465). 4/

Sequoia argues in its prehearing brief that the settlement agreement is not governed by the provisions of the Investment Company Act because it is not an insider. The argument is unsupported and without merit. Under §13(d) of the Securities and Exchange Act of 1934, 15 U.S.C. 78m, and Rule 13d-1 thereunder, 17 C.F.R. 240.13d-1, persons who have beneficial ownership of more

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4/ For example, for the investment advisor, who occupied three positions on the board, the payment of less than net asset value lowered the risk that the liquidation clause of the settlement agreement would come into play and end its advisory contract. The record does not establish that the negotiating process protected those stockholders who were not at the bargaining table from such conflicts.

than 5 percent of a class of securities must file Schedule 13D, 17 C.F.R. 240.101. Sequoia was an "affiliated person" of the Fund because it held over 5 percent of the Fund's common stock. Investment Company Act §2(a) (3), 15 U.S.C. 80a-2(a) (3). Rule 17d-1 defines the term "joint arrangement" broadly to include any "arrangement" where a fund and an affiliated person "have joint or a joint and several participation." Rule 17d-1 defines a joint arrangement to "mean any written or oral plan, contract, authorization or arrangement ... whereby a registered investment company ... and any affiliated person of ... such registered investment company ... have a joint or joint and several participation." Section 17(d) and Rule 17d-1 by their express terms apply to all affiliated persons regardless of whether the affiliated person is an insider. Section 17(d) was enacted to prevent affiliated persons from using their influence to cause an investment company to engage in transactions for the benefit of the affiliated persons. Congress was concerned with self-dealing. Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcom. of the Senate Comm. on Banking and Currency, 76th Cong., 3rd Sess. 767 (1940). Only some element of combination is required to establish a joint participation within the meaning of the statute. SEC v Talley Industries, Inc., 399 F.2d 396, 402-03 (2d Cir. 1968), cert. denied, 393 U.S. 1015 (1969)

The Division urges that the reimbursement of just Sequoia is overreaching by Sequoia and is contrary to the purposes and policies of the Investment Company Act. Sequoia concedes that its

goal was to achieve full net asset value or more for its shares and that if the Fund had not agreed to the reimbursement provision, it would have required a tender offer price closer to full net asset value. The result was that Sequoia received more for its shares than other shareholders and the net asset value of the Fund was reduced by $240,000. The reimbursement provision is unfair to the other stockholders.

Sequoia puts forth a number of reasons why it believes it would be good policy to permit the reimbursement of its proxy expenses: 1.) To not do so will weaken the rights of investment company shareholders who challenge management in a proxy fight. 2.) It is unfair to shareholders who must bear the cost and financial risk of challenging a fund's management to deny reimbursement. 3.) It is unfair to apply a prohibition against reimbursement to a stockholder who owns five percent or more of the stock because it penalizes large stockholders. 4.) The prohibition should not be applied where the goal is to change the fund's structure and not one of attempting to obtain the fund's investment advisory contract or control of the fund. 5.) To deny reimbursement would withhold from the shareholders of investment companies a right extended to shareholders of other public companies. 6.) It would deny stockholders a right permitted in resolving stockholder litigation. 7.) To prohibit reimbursement of proxy expenses would deny directors a useful tool for resolving legitimate disagreements between the managers of funds and their shareholders.

The issue is not whether benefits are derived from the reimbursement provision but whether it violates the Investment Company Act. In that regard, the Commission must examine whether affiliated shareholders are overreaching in any joint transaction, even one which has collateral benefits for all shareholders. 5/ Congress was specifically concerned about the fundamental fairness of closed-end investment companies repurchasing their securities from affiliates. See Senate Hearings at 294, 1118. See also SEC, Investment Trusts and Investment Companies, pt. 3 at 953-1000, H.R. Doc. No. 279, 76th Cong., 1st Sess. (1939). As the Division has pointed out in its brief, approval of this agreement would also be contrary to the tender offer rules which prohibit favoring one shockholder over another. Field v. Trump, 850 F.2d 938, 944 n. 1 (2d Cir. 1988).

The parties point out that the Commission has permitted reimbursement in stockholder derivative suits. But, as the Division correctly argues, those cases are merely implementing the rule that provides that plaintiffs are entitled to their litigation expenses for protecting the rights of all shareholders. In all instances of reimbursement cited by the applicants, none present the same

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5/ Sequoia also claims that there are direct benefits to the stockholders from the settlement agreement: preferred shareholders who wanted an immediate return on their shares received 95 percent of the net asset value of their shares, which was an increase in the market price; those shareholders who believed in the long term investment objective of the fund could remain with the Fund and benefit from an immediate increase in the net asset value of their shares (liquidation of the shares at 95 percent of net asset value increased the net asset value of the shares not tendered); and the settlement ended the dispute.

policy considerations raised by the applicants' settlement agreeement. One of the purposes of the Investment Company Act of 1940 is to eliminate abuses arising when investment companies are operated in the interest of affiliated shareholders rather than in the interest of all classes of their shareholders. 15 U.S.C. § 80a-1(b)(2). 6/ The settlement agreement between Sequoia and the Fund cannot be approved because it favors Sequoia over all other stockholders in the tender offer.

The Applicants Failed to Comply With the Requirement that All Arrangements between Affiliated Shareholders and Investment Companies Must Be Submitted to the Commission for Approval Prior to Adoption

Joint enterprises or arrangements between affiliated shareholders and investment companies are generally prohibited unless the Commission approves them. No affiliated person of any registered investment company may effect any transaction in connection with any joint enterprise or other joint arrangement in which an investment company is a participant unless an application is filed with the Commission and has been granted by an order

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6/ Section 1(b)(2) explicitly refers to abuses arising out of the operation of investment companies in the interest of affiliated persons, including affiliated shareholders to detriment of all shareholders. Sequoia argues that the reimbursement payment is not in violation of the foregoing provision of the Investment Company Act or a similar and direct prohibition in Securities Act Rule 13e-4. The applicants argue that because the payment will not be made during the tender offer, it is not pursuant to it since the tender took place three years ago. That argument ignores the record evidence which shows that Sequoia adjusted its demands for reimbursement according to a percentage of net asset value that would be paid in the tender offer.

entered "prior to submission" of the plan to the security holders or "prior to adoption" if not submitted to the shareholders. 17 C.F.R. 270.17d-1(a).

The Commission considers whether the participation of the investment company in a joint enterprise or arrangement is consistent with the provisions, policies, and purposes of the Act, and the extent to which such participation is on a basis different from, or less advantageous than, that of other participants. See The Vanguard Group, Inc., 47 S.E.C. 450, 454 (1981).

The applicants did not apply to the Commission for approval before they put the settlement agreement into effect. Twelve days before the application under consideration in this proceeding was filed, the Fund removed the $240,000 payment to Sequoia from the investment pool of the Fund. The money is now in an escrow account. Its removal lowered the net asset value used to compute the tender price on May 7, 1990, which was before the tender offer expired on May 10, 1990. Because of the necessary notice requirements, no action could have been taken by the Commission before the tender offer was completed.

The applicants argue that placing of the funds in escrow is not a joint transaction and preserved the status quo. That claim is not supported by law or the facts of record. The funds were removed from the investment pool pursuant to the settlement agreement before the application was filed. That affected the tender offer price and the pool of money available to the Fund.

The steps were taken pursuant to the joint agreement and were part of the agreed to transaction.

While escrow funds have been used in cases which required approval of the Commission under the Investment Company Act, they are not applicable to the facts presented here. In ML Venture Partners II, L.P., Investment Company Act Rel. Nos. 18847 (July 14, 1992) (notice) (51 SEC Dkt. 2138) and 18890 (August 11, 1992) (order) (52 SEC Dkt. 1015) money owed by a third party to the investment company and its affiliate was put in escrow until Commission approval was sought. The escrow account had no impact on the investment company or the affiliate and the investment company did not initiate the transaction. Other cases cited by the applicants involve escrow funds in an employees' security fund which the Commission has indicated are not precedent for investment companies generally (In the Matter of General Electric Company, 44 SEC 87 (1969).) and a business development company which is not subject to the same scrutiny as companies such as the Fund. Moreover, as the Division points out in the business development company case, Biotech Capital Corp. Investment Company Act Rel. Nos. 12602 (August 12, 1982) (notice) (25 SEC Dkt. 1425) and 12644 (Sept. 8, 1982) (order) (26 SEC Dkt. 126), the assets placed in escrow were the affiliate's, not the investment company's. In the only other case cited by the applicants, the money was placed in escrow to protect the investment company's interest in a secured loan transaction. The escrow fund prevented default and permitted the investment company to realize a stream

of income under the loan. See, Southeastern Capital Corp., Investment Company Rel. Nos. 12976 (Jan. 20, 1983) (27 SEC Dkt. 115) (notice) and 13031 (Feb. 17, 1983) (order) (27 SEC Dkt. 463).

The Commission has long read §17(b) as applying only to proposed transactions and once the transaction has been consummated it cannot exempt the transaction. Hugh B. Baker, 24 SEC 202, 205 (1946). While the Commission may exempt a transaction under §6(c), if the public interest will be served and it is consistent with the protection of investors, that is not the case here. Here, investors are treated differently depending on whether or not they are party to the settlement agreement. 7/

ACCORDINGLY, IT IS ORDERED that the application for an exemption under the Investment Company Act of 1940 filed by Counsellors Tandem Securities Fund, Inc and Sequoia Partners, L.P. is denied.

Pursuant to Rule 17(f) of the Rules of Practice, this initial decision will become the final decision of the Commission as to each party who has not, within fifteen days after service of this initial decision, filed a petition for review pursuant to Rule 17(b), unless the Commission, pursuant to Rule 17(c), determines on its own initiative to review the decision. If the applicants

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7/ The applicant raises various other arguments which have been considered and rejected. All proposed findings and conclusions submitted by the parties have been considered, as have their arguments. To the extent such proposals and contentions are consistent with this initial decision, they are accepted. The conclusions reached are based upon a preponderance of the evidence.

timely file a petition for review, or the Commission takes action to review, the initial decision will not become final.

Edward J. Kuhlmann
Administrative Law Judge

Washington, D.C.
July ~~13~~ 14, 1993