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April 15, 1997

Re: **Dean Witter Discover/Morgan Stanley Merger**

Mr. John V. O'Hanlon, Esq.
Assistant Chief Counsel
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Investment Company Act
Sections 2(a)(4), 15(a), 15(f)

Investment Advisers Act
Sections 202(a)(1), 205(a)(2)

Dear Mr. O'Hanlon:

We are writing on behalf of Dean Witter, Discover & Co. ("DWD") and Morgan Stanley Group Inc. ("MS") and their respective subsidiaries that serve as registered investment advisers to request that the staff of the Division of Investment Management of the Securities and Exchange Commission confirm that Sections 15(a)(4) and 15(f) of the Investment Company Act of 1940 (the "Investment Company Act"), and Section 205(a)(2) of the Investment Advisers Act of 1940 (the "Advisers Act") do not apply to the merger of DWD and MS because the merger does not involve or result in an "assignment" of any investment advisory contracts as that term is defined in Section 2(a)(4) of the Investment Company Act and Section 202(a)(1) of the Advisers Act.

## I. Description of the DWD/MS Merger

DWD and MS have agreed to merge, as equals, to form Morgan Stanley, Dean Witter, Discover & Co. DWD and MS are both publicly-traded holding companies, and are the ultimate parent companies of over 320 wholly-owned subsidiaries that offer a wide range of financial services, both in the United States and abroad, including asset management and investment advisory services. The merger of these parent holding companies will combine DWD's retail distribution

and asset gathering capabilities with MS's investment banking and institutional sales and trading operations.

After the merger, the combined company will be owned 55% by existing DWD holders and 45% by existing MS holders. DWD will be the surviving company and will continue its corporate existence under Delaware law under the name Morgan Stanley, Dean Witter, Discover & Co. ("MSDWD"). The merger will be accomplished through the conversion of MS stock into MSDWD stock and the subsequent cancellation of the MS stock. MS will cease to exist and all of its assets, including the stock of its operating subsidiaries, will become assets of MSDWD. MS shareholders will convert each share of MS common stock into the right to receive 1.65 shares of MSDWD common stock (cash will be paid in lieu of fractional shares). Each outstanding share of MS preferred stock will be converted into the right to receive one share of MSDWD preferred stock, which will have terms identical to the MS preferred stock that is exchanged.[1] DWD will issue duly authorized shares to effectuate the exchange with MS shareholders.

DWD is a publicly-owned company with approximately 322,000,000 shares of common stock outstanding. The stock is held by a widely-dispersed group of public and institutional shareholders. In the aggregate, DWD employees currently own approximately 12% of the outstanding common stock of DWD.[2]

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[1]Each outstanding share of MS Employee Stock Ownership Plan Convertible Preferred Stock ("ESOP Stock") will be converted into the right to receive one share of MSDWD ESOP Stock. MSDWD ESOP Stock will have terms identical to the MS ESOP Stock that is converted with two exceptions: (i) MSDWD ESOP Stock will be convertible into 3.3 shares of common stock in MSDWD and (ii) each share of MSDWD ESOP Stock will have voting rights equal to approximately 4.5 votes with respect to each matter that may be voted on by holders of the MSDWD common stock. The MS ESOP Stock is voted entirely in the discretion of its individual holders and is not subject to the MS voting agreements.

[2]Included in the 12% are the approximately 23,000,000 shares of common stock that are held by the DWD 401(k) Plan, which represents approximately 7% of the total outstanding common stock. Although these shares are voted by the trustee of the plan, they are voted in accordance with instructions received from each individual plan participant. If timely voting instructions are not received, the trustee votes those shares for which timely instructions have not been received in direct proportion to the voting of shares for which timely instructions have been received. Other than the stock held in the 401(k) Plan, DWD employees' stock is held directly. None of it is subject to any voting agreements or restrictions. After the merger, the DWD

Other than these employees and one set of commonly advised investors who are unaffiliated with either DWD or MS,[3] no single shareholder or group of shareholders owns more than 5% of the outstanding common stock.

DWD's asset management business is operated principally through its wholly-owned subsidiaries, Dean Witter InterCapital Inc. ("DWI") and Dean Witter Reynolds Inc. ("DWR"), which, after the merger, will remain wholly-owned subsidiaries of MSDWD. Both asset management subsidiaries are registered investment advisers. DWI serves as investment adviser or manager to approximately 100 registered investment companies ("Funds"). In addition, DWI and DWR together render investment advisory services to over 3,500 institutional and individual clients ("non-Fund advisory clients"). [4]

MS, also a publicly-held corporation, has approximately 158,000,000 shares of common stock outstanding. The stock is held by a widely-dispersed group of public and institutional investors; no single shareholder has more than a 5% stake. Approximately 1300 MS officers hold approximately 50,000,000 shares of common stock in MS, which they received pursuant to the initial recapitalization of MS in 1986 and subsequent compensation plans.[5] These MS officers hold this stock subject to a series of agreements, which subject the stock to certain

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employees will hold, in the aggregate, approximately a 7% stake in the post-merger company.

If all options currently exercisable were exercised and converted to common stock, the aggregate ownership of stock by DWD employees (including the 401(k) Plan) would constitute approximately 18% of the then outstanding stock of DWD. After the merger, that interest would represent approximately a 10% interest in the post-merger company.

[3]According to a Schedule 13G filed with the Commission on December 31, 1996 by Franklin Resources, Inc. ("FRI") and two principal shareholders of FRI, one or more open or closed-end investment companies or other managed accounts that are advised by direct or indirect investment subsidiaries of FRI beneficially owned in the aggregate shares representing 5.2% of the outstanding DWD common stock.

[4]In addition, DWR has a large number of advisory clients pursuant to its wrap fee programs.

[5]We note that there are additional MS employees who have received stock pursuant to compensation plans and that the MS officers whose stock is subject to the voting restrictions described below may also own additional stock which they have obtained outside of their compensation plans. None of this stock is subject to the voting restrictions described below.

restrictions on voting and, in certain cases, disposition. In the aggregate, this stock represents approximately 32% of the total outstanding common stock.[6]

MS's asset management business is conducted through a number of different direct and indirect wholly-owned subsidiaries, which, after the merger, will become direct or indirect subsidiaries of MSDWD. MS's principal U.S. advisory subsidiaries, Morgan Stanley Asset Management, Inc., Van Kampen American Capital Inc. and Miller Anderson & Sherrerd, LLP together advise over 200 Funds and serve as sub-adviser to approximately 30 Funds. In addition, MS has approximately ten wholly-owned subsidiaries that are registered investment advisers which serve as general partners to over 30 private investment partnerships. The MS advisory subsidiaries also render investment advisory services to approximately 730 non-Fund advisory clients.

By the terms of the merger agreement, the MSDWD board of directors will consist initially of two MS insiders, two DWD insiders and ten outside directors, with DWD and MS each initially designating five of the ten outsiders. The DWD designees will be nominated for election to the DWD Board at the DWD Annual Meeting at which time stockholders of DWD also will vote on the adoption of the merger agreement. The DWD designees elected to the DWD Board at the DWD Annual Meeting will be directors of the post-merger holding company upon consummation of the merger. The MS designees will also become directors of the post-merger holding company upon consummation of the merger. The board will be divided into three classes consisting of four, four and six directors, with initial terms expiring at the annual meetings of stockholders to be held in 1998, 1999, and 2000, respectively. Each class of directors elected at an annual meeting of stockholders after the merger will be elected for a 3-year term. Board members may only be removed for cause by a vote of 80% of the voting power of the stock of the merged companies. A majority of the board may increase or decrease the number of directors, provided that for approximately three years following the

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[6]Although the shares subject to these voting restrictions represent approximately 32% of the total outstanding common stock, they represent slightly less (*i.e.*, approximately 30%) of the total *voting rights* of MS, because there is outstanding ESOP Stock with voting rights which is not subject to the voting restrictions. The common stock and the ESOP Stock are voted as a single class. If all options awarded pursuant to the compensation plans that are currently exercisable were exercised and converted to common stock, the maximum amount of *voting rights* represented by the shares subject to the voting restrictions would be approximately 33%.

merger any change in the number of directors comprising the board to other than an even number requires a vote of ¾ of the members of the board.

DWD and MS initially will each have equal representation on MSDWD's major board committees, (an executive committee, a nominating and directors committee, an audit committee and a compensation committee). The current Chairman of MS will serve as Chairman of the Executive Committee. A three-quarters vote of the board will also be required for approximately three years following the merger to create additional committees, determine the number of directors comprising a committee, modify any of the powers or authority of the committees, change the chairman of a committee, remove a director from a committee or change any designated alternate committee member.

MSDWD will consist of five business units including retail asset management and institutional asset management; the advisory and fund businesses of each of DWD and MS are expected to be maintained and managed as separate entities. The Chairman and Chief Executive Officer of MSDWD will be the current Chairman and Chief Executive Officer of DWD. The President and Chief Operating Officer of MSDWD will be the current President of MS. Neither of these MSDWD officers can be removed without the approval of ¾ of the members of the board of directors.

Amendments to the MSDWD by-laws may be effected by a vote of 80% of the voting power of MSDWD stock or, except as set forth above, by a majority of the board.

## II. The Law

Section 15(a)(4) of the Investment Company Act requires that an advisory contract with an investment company provide for the contract's automatic termination in the event of its assignment. Similarly, Section 205(a)(2) of the Advisers Act provides that no assignment of an advisory contract can be made without the client's consent. In addition, sale of an interest in an adviser resulting in an assignment of an advisory contract with a registered investment company requires compliance with the independent director and unfair burden provisions contained in Section 15(f) of the Investment Company Act. If the merger does not involve the assignment of an advisory contract under Section 2(a)(4) of the

Investment Company Act, however, the merger will not trigger the safe harbor provisions of Section 15(f).

"Assignment" is defined under each Act to include "any direct or indirect *transfer* or hypothecation *of a contract..., or of a controlling block* of the assignor's outstanding voting securities[7] by a security holder of the assignor."[8] Although "controlling block" is not defined under either Act, "control" is defined under both Acts as "the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with such company."[9] In addition, the Investment Company Act provides for a rebuttable presumption of control where "any person...owns beneficially, either directly or indirectly through one or more controlled companies, more than 25% of the voting securities of a company." Conversely, a person who owns less than 25% of the voting securities of a company is presumed not to

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[7]"Voting security" is defined under the Investment Company Act as "any security presently entitling the owner or holder thereof to vote for the election of directors of a company." Investment Company Act §2(a)(42).

[8]See Investment Company Act §2(a)(4); Advisers Act §202(a)(1). The staff has interpreted the term "assignment" consistently under both Acts. See, e.g., Templeton Investment Counsel Ltd., SEC No-Action Letter (avail. January 22, 1986).

In addition, rules enacted under both Acts create a safe harbor for transactions that do not result in a change of *actual control or management* of the investment adviser by providing that such transactions should not be deemed an assignment. See Rule 2a-6; Rule 202(a)(1)-1. The proposing releases suggest that these rules were enacted to exclude transactions that technically constitute an assignment under the Acts' definition of the term, but which, in fact, do not alter the actual control or management of the adviser and thus do not raise concerns about "trafficking" in investment advisory contracts, against which the prohibitions on assignment were meant to protect.

Since it is our view that the merger does not give rise to an assignment within the language of the definitions under the Acts, we do not believe that it is necessary to analyze the merger under the safe harbor provisions. However, it should at least be noted that the merger certainly is consistent with the spirit of the safe harbor rules, since it does not in any way implicate the trafficking concerns underlying the Acts' proscriptions against assignments and does not involve an actual change in control or management of either company's investment advisory subsidiaries.

[9]See Investment Company Act §2(a)(9); Advisers Act §202(a)(12).

control the company.[10] The Advisers Act has no similar presumption.

With regard to what constitutes a "transfer of a controlling block" for purposes of an assignment analysis, the Division's interpretive positions on this issue as set forth in a number of responses to no-action requests (most of which have involved transfers of stock by a small number of shareholders in closely-held companies) have focused on changes in relative share ownership resulting from the transaction[11] and, in particular, whether a shareholder or group of shareholders is acquiring a controlling block (*i.e.* more than 25%).[12]

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[10]See Investment Company Act §2(a)(9).

[11]See, e.g., Lowry Management Corp., SEC No-Action Letter (avail. February 20, 1984) (The staff denied no-action relief where the largest single holder of stock, representing 28% of the voting power of the adviser, transferred the entire block to another company.); Smith Barney & Co., SEC No-Action Letter (avail. February 1976) (The staff granted relief even though 28% of the stock of Smith Barney was being "transferred" as a result of a merger with another firm because 72% of the stock of Smith Barney would continue to be held by directors, officers or employees of Smith Barney after the merger.); New England Asset Management Corp., SEC No-Action Letter (avail. November 23, 1973) (In the case of an adviser with three shareholders, all of whom were principal officers of the adviser, the staff denied no-action relief in part on the grounds that "the introduction of two new holders [with an aggregate stake of 36%] may completely alter the relationship between the principals.").

[12]See, e.g., Dean Witter, Discover & Co., SEC No-Action Letter (avail. February 8, 1993) (In its response granting no-action relief and affirming that the initial public offering of 20% of the stock of the parent of the adviser did not give rise to an assignment, the staff noted that the offering of stock would be "widely dispersed."); Central Corporate Reports Service, Inc., SEC No-Action Letter (avail. March 9, 1981) (The staff granted relief on the grounds that it "would not consider the broad and non-concentrated distribution of voting securities to the public by a company whose largest shareholder [was diluted from holding 91% to] 49.9 percent of the voting securities as constituting the transfer of a controlling block of stock requiring the consent of the company's clients for the continuance of existing advisory contracts."). Cf. Herzog v. Russell, 483 F. Supp. 1346, 1356 (E.D.N.Y. 1979) (In analyzing a shareholder's claim related to whether there was an assignment of an advisory contract, the court found that there was no assignment in part on the grounds that, as a result of the transactions, "[n]o single individual or related group of individuals received anywhere near 25% of the stock of [the parent of the adviser].").

## III. The DWD/MS Merger will not result in an "Assignment" of DWD or MS Advisory Contracts within the meaning of the Acts.

In our opinion, the merger of DWD and MS will not result in an assignment of the advisory contracts of either company's subsidiaries within the meaning of the Acts because neither company's subsidiaries will transfer any advisory contracts or transfer a controlling block of shares.

### A. Dean Witter Discover

There will be no transfer of any DWD advisory contracts or of a controlling block of outstanding shares in DWD as a result of the merger. DWD is the surviving corporate entity; it is issuing shares to MS holders.

As noted above, DWD is widely-held by public and institutional shareholders, with no single shareholder or group of shareholders owning more than 5% of the outstanding common stock.[13] Consequently, at present, there is no presumptively controlling (*i.e.*, owning more than 25% of the outstanding voting securities) or actually controlling shareholder of DWD. Thus, DWD will not "lose" a controlling shareholder as a result of its shareholders being diluted pursuant to the merger. At the same time, no "new" shareholder in the post-merger company will acquire a presumptively controlling block as a result of the shares to be issued by DWD in connection with the merger. Accordingly, DWD will not be subject to the introduction of a "new" controlling shareholder. In sum, no controlling block of stock in DWD is being transferred or acquired as a result of the merger.

For these reasons, the merger will not effect an "assignment" of the advisory contracts of DWD's subsidiaries within the meaning of that term under either Act.

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[13] See *supra* note 2 for a description of ownership by DWD employees.

**B. Morgan Stanley**

There will be no transfer of any MS advisory contracts or of a controlling block of shares in MS as a result of the merger.[14] MS's outstanding stock is currently held by a widely-dispersed group of public and institutional shareholders. There is no currently controlling shareholder that will be "transferring" a controlling block of shares as a result of the merger. In addition, no "new" shareholder in the post-merger company will acquire a presumptively, or actually, controlling block as a result of the merger. Accordingly, MS will not be subject to the introduction of a "new" controlling shareholder.

Nor is MS selling or spinning off any of its advisory subsidiaries. Rather, MS is merging as an equal with another widely-held financial services firm, which similarly has no currently controlling shareholder. Although, as a technical matter, MS will no longer be in existence as a separate entity after the merger, the MS advisory subsidiaries will continue in existence after the merger as direct or indirect wholly-owned subsidiaries of MSDWD. Consequently, after the merger, the MS advisory subsidiaries will continue to be wholly-owned, directly or indirectly, by a widely-held public company with no controlling shareholder.

▸ **MS Officers Do Not Hold a Controlling Block of MS Stock**

Approximately 32% of MS's outstanding common stock is held by approximately 1300 MS officers pursuant to a series of agreements that contain

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[14]The merger will take place at the holding company level only, and each of the DWD and MS advisory and fund businesses is expected to remain a direct or indirect subsidiary of MSDWD. No advisory or fund subsidiary will be merged out of existence and no advisory contracts will be transferred by any DWD adviser to any MS adviser or from any MS adviser to any DWD adviser as a result of the merger.

Certain investment advisory contracts of Morgan Stanley Asset Management ("MSAM") are in the process of being transferred to Van Kampen American Capital ("Van Kampen"). In one fund, MSAM will resign as the investment adviser and become sub-adviser, and Van Kampen will take MSAM's place as the adviser. In addition, it is possible that other contracts with Van Kampen may be transferred some time after the merger, although no decision to do so has been made. We are not requesting the staff's view on whether these transfers of advisory contracts or the merger out of existence of one of the advisers, if they were to occur, would constitute an assignment under Section 15(a)(4) of the Investment Company Act or Section 205(a)(2) of the Advisers Act.

certain restrictions on voting and, in certain cases, disposition.[15] After the merger, the aggregate interest of the shares held by these MS officers subject to the voting arrangements in the post-merger company will be diluted to approximately 14%. The voting provisions provide that, before any company-wide stockholder vote, these stockholders must take a preliminary vote of these shares. At the preliminary vote, these MS officers vote their shares *at their discretion*. Thereafter, at the time of the main stockholder vote, these shares are voted in accordance with the vote of the majority of the shares at the preliminary vote.

The dilution from 32% to 14% of the aggregate interest of the MS officers' shares that are subject to the voting arrangements does not constitute a transfer of a controlling block of stock within the meaning of the Acts because the shares held by the approximately 1300 MS officers subject to the voting arrangements are not, in our opinion, a "controlling block". As an initial matter, as with fluctuations in the public and institutional shareholder base, the amount of stock subject to these voting restrictions is subject to change as employees are promoted, retire or elect to sell their stock. In addition, these voting provisions differ from those of a traditional voting trust in that no specific individual or small group controls the vote of these shares. Rather, the voting provisions specifically provide that at the preliminary vote, each shareholder votes his shares at his sole discretion just as all other shareholders do in the general shareholder vote. Because there is no mechanism provided for in these agreements to coordinate the votes of the individual MS officers, no one person or group of persons is able to control the outcome and thereby set or influence company policy any more than if there was no voting arrangement. Rather, each holder is subject to the individual decisions on any given issue of the holders of a majority of the shares subject to the voting agreements because the agreements provide that the MS officers' shares will be voted according to the vote of a majority of shares cast in the preliminary vote. Therefore, the only effect of the voting arrangements is to enhance the collective presence in the main shareholder vote of those holders voting in the majority at the preliminary vote; it is not a mechanism through which any cohesive group can control the company. The agreements merely provide for majority decision making among these 1300 individual MS officers. From vote to vote, the individual MS officers comprising the majority are subject to change. On an

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[15] The number of shares subject to the voting arrangements and the number of individuals who have shares which may be subject to such arrangements are subject to change.

individual basis, none of these MS officers hold, subject to these voting arrangements, a significant percentage of the outstanding stock of MS.[16] For the same reasons that the widely-dispersed public ownership of MS as a whole is not considered a "controlling block" (even though a majority rules the votes of that "group"), the voting arrangement governing these shares held by the 1300 MS officers where each individual votes his shares at his discretion is not a controlling block.

It is our opinion that the dilution from 32% to 14% of the MS officers' shares that are subject to the voting arrangements does not constitute a transfer of a controlling block of stock of MS within the meaning of Section 2(a)(4) of the Investment Company Act or Section 202(a)(1) of the Advisers Act because the shares held by the 1300 MS officers subject to the voting agreements do not constitute a "controlling block" of MS stock.

- **Policy Considerations**

As a general matter, the DWD/MS merger is not the type of transaction that Section 15(a)(4) or Section 205(a)(2) was meant to prohibit. Section 15(a)(4) of the Investment Company Act and Section 205(a)(2) of the Advisers Act were designed to prevent trafficking in investment advisory contracts by ensuring that individuals entrusted with a fiduciary obligation to manage other people's money did not assign that obligation, either directly or by transferring control of an advisory entity, without the consent of their clients. These provisions protect the fiduciary relationship by guaranteeing that "the management contract is personal, that it cannot be assigned, and that you cannot turn over the management of other people's money to someone else."[17]

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[16]On a fully diluted individual basis (*i.e.*, assuming conversion of all currently exercisable options) and subject to these voting arrangements, one individual officer owns approximately 2.6% of the total outstanding common stock of MS; two individual officers each own between 1% and 2%; and six individual officers each own between approximately .5% and 1%. The rest of these approximately 1300 officers own, on a fully diluted individual basis subject to these voting arrangements, less than .5% of the total outstanding stock of MS, with the vast majority of them owning less than .25%.

[17]Investment Trusts and Investment Companies: Hearings on S.3580, 76th Cong. 3d Sess. 253 (1939) (statement of David Schenker, Chief Counsel, Securities and Exchange

The DWD/MS merger will not result in any "transfer" of fiduciary obligations by the MS investment advisers. MS is not selling its advisory businesses for cash or otherwise transferring its assets, contracts or fiduciary obligations. Rather, the MS entities and personnel responsible for the operation of the advisers will be remaining with the newly merged company.

The Commission has recognized in other contexts that Sections 15(a)(4) and 205(a)(2) should not be rigidly and formalistically applied to transactions that do "not contain any of the abusive elements which Congress would have considered to be trafficking in investment advisory . . . contracts."[18] Although we are not seeking to rely on the safe harbor rules, we do believe that the same policy considerations that motivated the implementation of the safe harbors support a finding that this merger does not constitute an assignment of the MS advisory contracts. Like transactions within the purview of the safe harbors, this transaction will not change the actual control of an adviser or the manner in which investment advisory services will be provided.

In sum, the DWD/MS merger will not effect an "assignment" of the MS advisory contracts within the meaning of that term under either Act.

## IV. CONCLUSION

For the reasons set forth above, we are of the opinion that the merger of DWD and MS will not result in an "assignment", as that term is defined in Section 2(a)(4) of the Investment Company Act and Section 202(a)(1) of the Advisers Act, of any investment advisory or sub-advisory contracts that subsidiaries of MS or DWD have with any public Funds, private investment partnerships or non-Fund advisory clients. We respectfully request that the Division confirm that based on the facts described herein the merger of DWD and MS does not involve an "assignment", as that term is defined in Section 2(a)(4) of the Investment Company Act and Section 202(a)(1) of the Advisers Act, of any of the investment advisory contracts covered by this letter.

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Commission Investment Trust Study).

[18]Investment Company Act Release No.10809 (Aug. 6, 1979) (proposing Rule 2a-6).

If the Division requires additional factual information or further analysis, please do not hesitate to contact me at 212-450-4525 or Nora Jordan at 212-450-4684. We thank you for your prompt consideration of this matter.

Very truly yours,

Pierre de Saint Phalle