

MEMO# 2575

March 5, 1991

COURT ALLOWS CLAIMS ALLEGING MISLEADING DISCLOSURE FOR CLOSED-END HIGH YIELD BOND FUND TO PROCEED

March 5, 1991 TO: SEC RULES MEMBERS NO. 18-91 CLOSED-END FUND MEMBERS NO. 14-91 RE: COURT ALLOWS CLAIMS ALLEGING MISLEADING DISCLOSURE FOR CLOSED-END HIGH YIELD BOND FUND TO PROCEED

_____ In a recent case, the United States District Court for the District of Massachusetts rejected the defendants' motion to dismiss claims under Section 11 and Section 12(2) of the Securities Act in connection with alleged misrepresentations in the prospectus for a leveraged closed-end fund that invested in high yield bonds. A copy of the court's decision is attached. Plaintiffs, who were shareholders of the fund, had filed suit against the fund, its directors, its investment adviser, its lead underwriters and Michael Milken. Among their allegations were that the fund's prospectus understated the risk and overstated the rewards of high yield bonds, that the fund's purchases of securities were made in order to provide a "market of last resort" for bonds underwritten by Drexel Burnham Lambert and that the prospectus failed to disclose that the fund's portfolio securities were "skewed toward the higher risk end of the high yield bond market". Although the court found that the prospectus adequately described the risks associated with the fund's shares, it concluded that the plaintiffs successfully alleged a claim under Section 11 and Section 12(2) with respect to three allegations: (1) that the use of a high yield bond index (the "DBL Composite") would have been misleading if the defendants knew the fund was being used to purchase Drexel's least desirable bonds, (2) that disclosure that the fund would use defensive and hedging techniques to reduce risk would have been misleading if the defendants knew such techniques would not be used and (3) that disclosure that the fund would invest primarily in bonds issued by "growth stage" companies would have been misleading if the defendants knew the fund would focus on bonds issued in connection with mergers and takeovers. However, the court dismissed the plaintiffs' 10b-5 and common law fraud claims on the grounds that the plaintiffs failed to show that the alleged misrepresentations were the cause of their injury. Craig S. Tyle Associate General Counsel Attachment