

Joint Appendix

No. 90-1278

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In the Supreme Court of the United States

OCTOBER TERM, 1990

INDOPCO, INC.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

**ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE THIRD CIRCUIT**

JOINT APPENDIX

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**PETITION FOR CERTIORARI FILED FEBRUARY 11, 1991
CERTIORARI GRANTED MAY 13, 1991**

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RELEVANT DOCKET ENTRIES**United States Tax Court**

09/07/84	Petition filed.
11/06/84	Answer filed.
03/18/86	Motion by petitioner for summary judgment filed.
05/30/86	Motion by respondent for summary judgment filed.
10/20/86	Order filed denying petitioner's motion for summary judgment (filed 03/18/86) and respondent's motion for summary judgment (filed 05/30/86).
12/04/86	Amendment to answer filed.
06/16/87	Trial before Judge Clapp.
06/16/87	Stipulation of facts with attached exhibits filed.
06/16/87	Supplemental stipulation of facts with attached exhibits filed.
07/24/89	Findings of Fact and Opinion of Judge Clapp issued.
07/26/89	Decision for respondent entered.
10/20/89	Notice of appeal filed.
10/20/89	Bond in the amount of \$2,150,000 issued by Seaboard Surety filed.

**United States Court of Appeals
for the Third Circuit**

- 03/16/90 Oral argument held.
- 11/13/90 Opinion affirming judgment of Tax Court issued; judgment entered.
- 11/28/90 Order entered amending 11/13/90 opinion by deleting footnote.
- 12/03/90 Motion by appellant to stay mandate filed.
- 12/19/90 Order granting motion to stay mandate to and including 02/11/91 filed.

United States Supreme Court

- 02/11/91 Petition for writ of certiorari filed.
- 04/30/91 Brief for respondent filed.
- 05/13/91 Petition for writ of certiorari granted.

UNITED STATES TAX COURT

NATIONAL STARCH AND)	
CHEMICAL CORPORATION)	
Petitioner,)	
v.)	Docket
)	No. 31669-84
COMMISSIONER OF)	
INTERNAL REVENUE,)	
Respondent.)	

PETITION

(Filed September 7, 1984)

The Petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (bearing symbols A:Nwk:NBB:GT:90D) dated June 12, 1984, and for a determination of an overpayment of Federal income tax, and as the basis for its case alleges as follows:

1. The Petitioner is a corporation organized and existing under the laws of the State of Delaware, having its principal office at 10 Finderne Avenue, Bridgewater, New Jersey 08807. The Petitioner's employer identification number is 13-1522451. The return for the period here involved was filed with the Office of the Internal Revenue Service at Holtsville, New York.

2. The notice of deficiency (a copy of which, including so much of the statement and schedules accompanying the notice as is material, is attached and

marked Exhibit A) was issued by the Office of the Internal Revenue Service at Newark, New Jersey, and was mailed to the Petitioner on June 12, 1984.

3. The deficiency as determined by the Commissioner is in income taxes for the taxable period ended August 15, 1978, in the amount of \$1,068,281.00 all of which is in dispute. In addition, Petitioner claims that it made an overpayment of income tax in the amount of \$338,918 for such taxable period.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) The Respondent erred in determining that the payment of \$2,225,586.00 to Morgan Stanley and Company, Incorporated ("Morgan Stanley") for professional advisory fees represents a capital expenditure and, therefore, is not deductible as an ordinary and necessary business expense.

(b) The Respondent erred in failing to reduce the income tax liability of Petitioner for the taxable period ended August 15, 1978 for certain expenses totalling \$706,079 for legal fees, auditors' fees, printing costs of a proxy statement, proxy solicitation expenses, employee compensation consultants' fees and SEC filing and other fees, all of which were incurred by Petitioner in connection with a transaction whereby Petitioner was acquired by another company and which are deductible as ordinary and necessary business expenses but were improperly capitalized by Petitioner as reflected in Schedule M of its income tax return for such period.

5. The facts upon which the Petitioner relies, as the basis of its case, are as follows:

(a) In October, 1977, Unilever United States Inc. ("Unilever") approached the management of Petitioner, as well as its two largest shareholders, Anna A. and Frank K. Greenwall (the "Greenwalls"), to express an interest in acquiring the stock of Petitioner.

(b) Soon thereafter, the management of Petitioner informed its Board of Directors of the Unilever expression of interest in acquiring the stock of Petitioner and of the Greenwalls' disposition toward a favorable response.

(c) The Board decided that it should not proceed to consider its response to the Unilever expression of interest in acquiring the stock of Petitioner without first obtaining the advice of an independent investment banking firm.

(d) On or about November 14, 1977, Petitioner engaged the services of Morgan Stanley, confirmed by a letter of December 6, 1977, to review the situation arising from the Unilever expression of interest in acquiring the stock of Petitioner and advise the officers and directors of Petitioner as to appropriate courses of action in response to such expression of interest by Unilever.

(e) Retaining the advice of a qualified investment banking firm is, and was at the time that Morgan Stanley was hired by Petitioner, a common and prudent practice for the officers and directors of a potential target company when faced

with an unsolicited bid for acquisition of a controlling interest in its stock.

(f) Pursuant to the retention of the services of Morgan Stanley, the officers and directors of Petitioner consulted with and received the advice of Morgan Stanley regarding the acquisition of the stock of Petitioner by Unilever.

(g) On or about March 16, 1978, the Board of Directors of Petitioner approved the terms of an agreement and plan of merger whereby Unilever would indirectly acquire the stock of Petitioner in a reverse subsidiary merger. The plan called for Unilever to create a subsidiary holding company, National Starch and Chemical Holding Corporation ("Holding") which, in turn, would create a wholly-owned second-tier subsidiary, NSC Merger, Inc. which would merge into Petitioner, with the shareholders of Petitioner receiving cash for their shares.

(h) In July 1978, a proxy statement was sent to the shareholders of record of Petitioner informing them of a special meeting to be held to vote on the plan of merger.

(i) Attached to the proxy statement sent in July 1978 to shareholders of record of Petitioner was an offer by Holding to exchange shares of nonvoting preferred stock of Holding for shares of stock of Petitioner.

(j) The Board of Directors of Petitioner recommended that the shareholders vote in favor of the merger and included in the proxy materials the opinion of Morgan Stanley, rendered to the Board,

that the offer to the shareholders was fair and equitable.

(k) In August 1978, the shareholders approved the merger.

(l) On or about August 15, 1978, the merger was consummated with over 80% of the stockholders receiving cash in exchange for their shares in Petitioner, the remainder of the shareholders of Petitioner having elected to exchange their shares for shares of preferred stock of Holding pursuant to the exchange offer.

(m) The transaction, though a merger in form, was in substance a purchase by Holding, a subsidiary of Unilever, of Petitioner's stock for cash or preferred stock of Holding.

(n) As the target corporation whose stock was acquired, Petitioner neither acquired nor enhanced any asset as a result of the transaction.

(o) The services performed by Morgan Stanley consisted of (i) advice to and consultation with the officers and directors of Petitioner to assist them in responding to the unsolicited offer of Unilever and in deciding whether to approve or disapprove the plan of merger and to recommend such approval or disapproval to the shareholders and (ii) the rendering of an opinion, in support of the decision of the Board of Directors of Petitioner to approve the plan of merger, that the terms of Unilever's offer were fair and equitable.

(p) The Board of Directors had Petitioner engage the services of Morgan Stanley in order to protect, rather than acquire, property and to as-

sist the officers and directors of Petitioner in the proper discharge of their fiduciary obligation to Petitioner's shareholders.

(q) The Morgan Stanley fee was both an ordinary and a necessary expense of Petitioner.

(r) Petitioner incurred expenses totalling \$706,079 for legal fees, auditors' fees, printing costs of the proxy statement, proxy solicitation expenses, employee compensation consultants' fees and SEC filing and other fees, all in connection with the plan of merger, which it expensed on its books of account but which were capitalized for Federal income tax purposes as reflected in Schedule M of its return.

(s) The expenses referred to in paragraph (r) did not create or enhance an asset of Petitioner.

(t) The expense referred to in paragraph (r) were both ordinary and necessary expenses of Petitioner.

(u) A claim for refund for an overpayment of income tax resulting from the capitalization rather than deduction of the expenses referred to in paragraph (r) has not been filed. However, had such a claim been filed on the date of the mailing of the notice of deficiency, the claim would have been timely.

WHEREFORE, Petitioner prays that this Court may hear its case, determine that there is no deficiency in Federal income tax due from the Petitioner for the taxable period ended August 15, 1978, determine that an overpayment of income tax in the amount of \$338,918 was made for such taxable period and grant

Petitioner any other and further relief to which it may be entitled.

(Signatures omitted in printing)

UNITED STATES TAX COURT

(Caption omitted in printing)

ANSWER

(Filed November 6, 1984)

THE RESPONDENT, in answer to the petition filed in this case, admits and denies as follows:

1. through 3. Admits

4. (a) and (b) Denies.

5. (a) through (n) Denies for lack of sufficient present knowledge.

(o) through (q) Denies.

(r) Denies for lack of sufficient present knowledge.

(s) and (t) Denies.

(u) Denies for lack of sufficient present knowledge.

6. Denies generally each and every allegation of the petition not hereinbefore specifically admitted, qualified or denied.

WHEREFORE, it is prayed that the deficiency determined by the respondent be in all respects approved.

**(Signature and certificate of service
omitted in printing)**

UNITED STATES TAX COURT

(Caption omitted in printing)

AMENDMENT TO ANSWER

(Filed December 12, 1980)

THE RESPONDENT, for an Amendment to Answer filed in the above-entitled case, adds after paragraph 6. of the Answer and prior to the prayer, the following paragraph:

7. FURTHER ANSWERING the petition, the respondent herewith notifies the petitioner that he is relying upon the additional theory for disallowance of the claimed deduction for amounts paid to Morgan Stanley & Co. and any "Ancillary Expenses" claimed as additional deductions in the petition that these expenditures are not deductible by petitioner because they were made primarily for the benefit of petitioner's shareholders and therefore are not "ordinary and necessary" within the meaning of I.R.C. §162.

WHEREFORE, it is prayed that the deficiency determined by the respondent be in all respects approved.

(Signature omitted in printing)

UNITED STATES TAX COURT

(Caption omitted in printing)

STIPULATION OF FACTS

(Filed June 16, 1987)

In accordance with Tax Court Rule 91, it is hereby agreed by and between the parties hereto that for purposes of this case the following facts are to be considered true and correct, subject to the terms of this preamble. All stipulated facts shall be treated as conclusive admissions. All stipulated exhibits shall be considered authentic. The truth of assertions within stipulated exhibits may be rebutted or corroborated by additional evidence. All copies of documents shall be treated as if they were the original documents. Any evidentiary objections that are not specifically expressed within this stipulation may be made in accordance with Tax Court Rule 91.

1. Petitioner is a corporation organized and existing under the laws of the State of Delaware. During the period in issue and at the time of the filing of the petition herein, Petitioner had its principal office in Bridgewater, New Jersey. It uses the accrual method of accounting for Federal income tax purposes. Its Federal income tax return for the period from January 1 to August 15, 1978 ("1978 fiscal year"), was filed with the Internal Revenue Service Center in Holtsville, New York. A copy of such return (Form 1120 and supporting schedules and attachments) is attached as Exhibit 1-A.

2. By statutory notice dated June 12, 1984 (a copy of which is attached as Exhibit 2-B), Respondent

determined a deficiency in Petitioner's income tax for its 1978 fiscal year in the amount of \$1,068,281.

3. Petitioner has been and is engaged in the manufacture and sale, primarily for industrial use, of adhesives, starches and specialty chemical products in the United States and certain foreign countries. Immediately prior to August 15, 1978, Petitioner's authorized capital stock consisted of 250,000 shares of preferred stock, no par value, none of which was issued or outstanding, and 8,000,000 shares of common stock, par value \$.50 per share, approximately 6,563,930 shares of which were issued and outstanding. Petitioner's common stock was then publicly held (by approximately 3,700 shareholders of record) and was actively traded on the New York Stock Exchange. Petitioner's directors, officers and their families held about 25 percent of Petitioner's common stock and about 75 percent of Petitioner's common stock was held by the public. Copies of the 1977 and 1978 Annual Reports of Petitioner are attached as Exhibit 3-C.

4. Unilever United States, Inc. ("Unilever U.S."), is a corporation organized and existing under the laws of the State of Delaware, with its principal office in New York City. It is a holding company, the principal subsidiaries of which, immediately prior to August 15, 1978, were Lever Brothers Company and Thomas J. Lipton, Inc. Those two corporations have been and are engaged principally in the manufacture and sale in the United States of foods, tea and other drinks, detergents and toilet preparations. All the outstanding stock of Unilever U.S. is owned by Unilever N.V., a publicly held Netherlands corporation which, together with Unilever PLC, a publicly held United Kingdom corporation, and companies directly or indirectly

owned or controlled by them, comprise the Unilever Group. The Unilever Group has been and is engaged in the manufacture and sale in the United States and many foreign countries of a wide variety of goods for common household use. A copy of the 1977 Annual Report of Unilever N.V. is attached as Exhibit 4-D.

5. On August 15, 1978, National Starch and Chemical Holding Corporation ("Holding"), a Delaware subsidiary of Unilever U.S. organized for the purpose, acquired all the outstanding common stock of Petitioner in exchange for 1,313,383 shares of preferred stock of Holding with an aggregate par value of \$96,533,650 and \$380,151,075 in cash. One hundred seventy-nine shareholders, holding approximately 21 percent of Petitioner's common stock, voluntarily exchanged their stock on a share-for-share basis for the Holding preferred stock, having a par value of \$73.50 per share, and the common stock of Petitioner held by its other shareholders was exchanged for \$73.50 per share in cash. Petitioner thereupon became an indirect wholly owned subsidiary of Unilever U.S. and a member of its affiliated group for Federal income tax purposes. A copy of an Amended Final Report dated August 15, 1978, by the Depository Agent (Morgan Guaranty Trust Company of New York) reflecting those of Petitioner's shareholders (or their designated nominees) that accepted the Exchange Offer is attached as Exhibit 5-E.

6. The acquisition of Petitioner's stock by Holding as described in paragraph 5 above was accomplished pursuant to an Exchange Offer dated July 10, 1978 ("the Exchange Offer"), in which Holding offered to issue its preferred stock in exchange for any amount of Petitioner's common stock, and an Agree-

ment and Plan of Merger dated as of March 16, 1978 (the "Merger Agreement"), which provided for a conversion into cash of any common stock of Petitioner that was not acquired by Holding pursuant to the Exchange Offer. Such cash was contributed by Unilever U.S. to Holding and then by Holding to its newly formed subsidiary, which was merged into Petitioner pursuant to the Merger Agreement. Copies of the Exchange Offer and the Merger Agreement are attached as Exhibits 6-F and 7-G, respectively.

7. The use of a merger under Delaware law as described above, referred to as a "reverse subsidiary cash merger," assured Unilever U.S., if the merger was approved by two-thirds of Petitioner's shareholders, of obtaining 100 percent of the common stock of Petitioner.

8. Prior to the acquisition of Petitioner's stock by Holding, the Internal Revenue Service (the "IRS") issued a ruling letter dated June 28, 1978 (a copy of which is attached as Exhibit 8-H), which held, in part, that for Federal income tax purposes Petitioner's shareholders that accepted the Exchange Offer and received Holding preferred stock for common stock of Petitioner should treat the transaction as a tax-free exchange under Section 351 of the Internal Revenue Code while those shareholders of Petitioner that received cash for their shares should treat the transaction as a taxable purchase of their common stock of Petitioner by Holding for cash, the formation of Holding's subsidiary and its merger into Petitioner being disregarded.

9. After the acquisition of Petitioner's stock by Holding, the management and business operations of

Petitioner, its subsidiaries and joint ventures were continued as theretofore. Petitioner's directors and officers remained in office and its key officers and employees executed employment contracts with Petitioner as required by the Merger Agreement. Petitioner did not by virtue of the acquisition of its stock acquire any property or services from any member of the Unilever Group. No property or assets of Petitioner were sold or otherwise disposed of by virtue of the acquisition of its stock. Nothing herein shall preclude the Respondent from contending that Petitioner's affiliation with Unilever (a consequence of the acquisition of its stock) resulted in the acquisition of an intangible asset. Petitioner's capital structure, both debt and equity, remained unchanged, except that, pursuant to the Merger Agreement, Petitioner's Certificate of Incorporation was amended to eliminate its previously authorized shares of preferred stock and to reduce the total number of its authorized shares of common stock to 1,000, par value \$1 per share. Copies of the Restated Certificate of Incorporation of Petitioner filed May 6, 1970, the Restated Certificate of Incorporation of Petitioner dated August 16, 1978, and the Restated Certificate of Incorporation of Holding filed August 14, 1978, are attached as Exhibits 9-I, 10-J and 11-K, respectively.

10. The acquisition of Petitioner's stock on August 15, 1978, was preceded by discussions between Petitioner and Unilever U.S. In such discussions, Unilever U.S. was represented by the investment banking firm of Lazard Freres & Co. ("Lazard"). The law firm of Debevoise, Plimpton, Lyons & Gates ("DPL&G"), which had been legal counsel to Petitioner for many years, acted as legal counsel to Petitioner in

connection with the discussions and the documentation and implementation of the transaction. The law firm of Cravath, Swaine & Moore ("CS&M") acted as legal counsel to Unilever U.S. in such connection.

11. The discussions were initiated on October 7, 1977, when the Unilever Group, through Lazard, indicated that it was interested in acquiring 100 percent of Petitioner's stock. Felix Rohatyn, a partner of Lazard, met, at Mr. Rohatyn's request, with Frank K. Greenwall (who was Chairman of the Executive Committee of Petitioner's Board of Directors and who, together with his wife, Anna A. Greenwall, owned approximately 14-1/2 percent of Petitioner's outstanding common stock) and Donald D. Pascal, Chairman of Petitioner's Board of Directors, and indicated that the Unilever Group was looking at a number of U.S. companies, including Petitioner, with the possibility of acquisition in mind. This was the first time that either Mr. Greenwall or Mr. Pascal was aware of such an interest. Mr. Rohatyn asked whether Mr. Greenwall would be willing to discuss the possibility of a cash sale of Petitioner's shares by Mr. Greenwall and his wife to Unilever U.S. as part of an acquisition of all of Petitioner's shares by Unilever U.S. Mr. Rohatyn indicated that Unilever U.S. was not thinking of an "unfriendly" tender situation and would proceed with discussions only if the Greenwalls were willing to sell their shares and, in that event, only if Petitioner favored the acquisition. Mr. Greenwall told Mr. Rohatyn that he would give the question some thought.

12. At the time of the transaction at issue, Frank K. Greenwall was 81 years of age and his wife was 79 years of age. Prior to serving as Chairman of

the Executive Committee of Petitioner's Board of Directors, Mr. Greenwall had served as Petitioner's President and Chairman of the Board of Directors. The Greenwalls' tax basis for their common stock of Petitioner was less than \$15.00/share. Mr. and Mrs. Greenwall were shareholders of Petitioner for many years prior to the initial public offering of Petitioner's common stock.

13. After consulting with his legal advisors (the firm of DPL&G, which had also represented Mr. Greenwall and his wife for a number of years) and his accountant, Mr. Greenwall indicated that, because of estate planning considerations, he and his wife would voluntarily dispose of their shares only in a tax-free transaction that would be available to other shareholders of Petitioner that so desired. Thereafter, during mid-October through early November 1977, CS&M and DPL&G met a number of times to discuss possible mutually acceptable structures to make a tax-free transaction available in the overall context of a stock acquisition for cash. A structure was proposed by CS&M, the basic elements of which are described in paragraph 6 (the "Structure"). The Structure was discussed with DPL&G, and later it was decided to explore with representatives of the IRS in the Rulings Branch in Washington whether the contemplated Structure would be acceptable to the IRS.

14. On November 3, 1977, CS&M and DPL&G met with IRS officials in the Rulings Branch of the National Office in Washington at a presubmission conference. At that meeting the Structure that had been devised was discussed.

15. On November 7, 1977, after a regular meeting of Petitioner's Board of Directors, the directors were informed of the inquiry on behalf of Unilever U.S. and the proposed Structure for an acquisition of Petitioner's stock by a subsidiary of Unilever U.S. The directors decided that no further steps on a decision as to a possible acquisition would take place unless the proposed Structure was satisfactory, and that if it appeared that the proposed Structure was satisfactory, no negotiations should be conducted or decision on terms reached without advice from an independent investment banking firm.

16. On November 14, 1977, Petitioner engaged Morgan Stanley and Co. Incorporated ("Morgan Stanley") to assist and advise Petitioner's Board of Directors. Morgan Stanley was (and continues to be) a leading investment banking firm in the United States and often is involved in representing companies like Petitioner in connection with similar proposed transactions. By letter dated December 6, 1977 (a copy of which is attached as Exhibit 12-L), Morgan Stanley provided a description of its approach to matters of this nature and a schedule of the fees that it charged for its services. By letter dated the same date (a copy of which is attached as Exhibit 13-M), Petitioner confirmed Morgan Stanley's engagement.

17. To carry out its engagement by Petitioner, Morgan Stanley assigned a team of four people from its Mergers & Acquisitions Department to deal with

the project (titled "Project Buttndown"). The team consisted of the following persons:

Robert F. Greenhill - Managing Director

R. Bradford Evans - Vice President

Dennis Haydon - Associate

Karen Flannery - Analyst

18. As an initial matter, prior to rendering any advice, the Morgan Stanley team undertook a careful and detailed review of Petitioner, its business, its shareholders and market trends with the object of fixing a range of values at which an offer from Unilever U.S. would be acceptable from a financial point of view. The team also analyzed the proposed Unilever U.S. transaction (as it had been developed to that point) and considered whether there was any potential interest by other parties in Petitioner. During early December 1977, Morgan Stanley also met with DPL&G and with Lazard with respect to the proposed Structure and the terms of the restrictive covenants for inclusion in Holding's Certificate of Incorporation.

19. The Morgan Stanley team findings were summarized in a report (a copy of which is attached as Exhibit 14-N) and were discussed with other Morgan Stanley personnel in the Mergers & Acquisitions Department and related areas to ensure as broad a consensus within the firm as possible. Thereafter, Mr. Greenhill discussed the findings with representatives of Petitioner and obtained its authorization to ascertain from Unilever U.S. the amount that Unilever U.S. might be willing to offer for Petitioner's stock and the terms under which an offer might be made.

20. During early December, 1977, Mr. Greenhill (assisted by R. Bradford Evans) carried on discussions, under the direction and control of Petitioner, with Mr. Rohatyn and Peter Jacquith of Lazard regarding the value that Unilever U.S. would be willing to offer for each share of Petitioner's common stock. The discussions culminated in an offer by Unilever U.S. of \$73.50 per share for Petitioner's stock. This value was a compromise reached between the value sought by Petitioner and that offered by Unilever U.S.

21. On December 11, 1977, a special meeting of Petitioner's Board of Directors was held at which Morgan Stanley submitted an oral report on the results of its evaluation of the Unilever U.S. offer of \$73.50 per share. This oral report was accompanied by a document entitled "Project Butttdown" (a copy of which is attached as Exhibit 15-O), which contained 26 exhibits summarizing the results of Morgan Stanley's work. At such meeting, after taking into account Morgan Stanley's report, Petitioner's Board of Directors approved the form of a letter of intent relating to the acquisition of Petitioner's common stock by Unilever U.S., and on the same date the Letter of Intent (a copy of which is attached as Exhibit 16-P) was executed by Petitioner and Unilever U.S. At the meeting there was also elected a special committee of the Board comprised of three outside directors, designated as the Merger Committee of the Board of Directors, to supervise the investigations contemplated by and to assist in the negotiations relating to the carrying out of the Letter of Intent and to advise the Board of the outcome of such investigations. A copy of the minutes of the meeting is attached as Exhibit 17-Q. A copy of Morgan Stanley's presentation outline for the Decem-

ber 11, 1977, Board of Directors meeting is attached as Exhibit A. Petitioner stipulates only that Exhibit A is an authentic copy of a document prepared by Morgan Stanley but does not stipulate as to the truth of the contents and reserves all other evidentiary objections.

22. Subsequent to the execution of the Letter of Intent and prior to the execution of the Merger Agreement, Morgan Stanley performed a due diligence review of Petitioner and the Unilever Group that involved a detailed investigation of the facts necessary to update and support its opinion regarding the transaction. Morgan Stanley also assisted the Merger Committee of Petitioner's Board of Directors in finalizing the terms of the preferred stock of Holding and assuring that the financial aspects of the transaction did not result in unequal treatment among Petitioner's shareholders. In this regard, Morgan Stanley also participated by briefing Petitioner's Board of Directors and reviewing the proposed merger documents, proxy and prospectus drafts, employment contract drafts and proposed ruling request. Representing some of the work performed by Morgan Stanley are copies of the following items attached as exhibits as indicated:

<i>Description</i>	<i>Exhibit</i>
- 12/20/77 "List of Major Due Diligence Considerations"	B
- 12/22/77 letter (Dennis Haydon) to DPL&G (K.L. Wallach) re Due Diligence Inquiries	C

- 1/8/78 Memorandum re Agenda for Due Diligence session with Unilever management D
- 1/22/78 Memorandum re Initial Due Diligence Session with Petitioner's Management E
- 2/5/78 Outline for Briefing of Petitioner's Board of Directors F
- 2/6/78 Memorandum from D.R. Haydon to Project Buttndown Team re Meeting with Petitioner's Board of Directors G

Petitioner stipulates only that these documents are authentic copies of items prepared by Morgan Stanley, but does not stipulate as to the truth of the contents thereof and reserves all other evidentiary objections.

23. A written ruling request concerning the proposed structure of the transaction was submitted by DPL&G to the IRS by letter dated January 6, 1978 (a copy of which, together with supplemental submissions dated March 23 and June 7, 1978, is attached as Exhibit 18-R), and, as indicated in paragraph 8 above, in response to such request a favorable ruling on the proposed structure was issued by the IRS by letter dated June 28, 1978.

24. By February, 1978, agreement on the definitive terms of the Merger Agreement and Exchange Offer had been reached and Morgan Stanley had completed its due diligence reviews of the transaction as proposed and of Petitioner and Unilever U.S. At this point, prior to Petitioner's Board of Directors executing the Merger Agreement and Morgan Stanley's

recommendation to the Board of Directors on whether to do so, the Morgan Stanley project team again presented its findings to other personnel in the Mergers & Acquisitions Department and related areas and solicited their views. A briefing outline and summary memorandum were prepared for use at the meeting. Copies of the following documents regarding the Morgan Stanley February, 1978 "firm meeting" on this matter are attached as exhibits as indicated:

<i>Description</i>	<i>Exhibit</i>
- 2/12/78 Meeting Notice	H
- Presentation Outline for 2/21/78 Firm Meeting	I
- "Project Buttndown" Summary Memorandum (w/Exs "A" - "F")	J
- 2/16/78 Memorandum to Dennis Haydon from W.F. Kroener, III, Esq. of Davis Polk & Wardwell (Morgan Stanley's counsel) re "Meaning of 'Equitable' in Valuation Opinion"	K

Petitioner stipulates only that these documents are authentic copies of items prepared by Morgan Stanley but does not stipulate as to the truth of the contents thereof and reserves all other evidentiary objections.

25. The project team's opinion and findings were approved at the Merger & Acquisitions "firm meeting" and thereafter Mr. Greenhill presented the opinion and findings at the meeting of Petitioner's Board of Directors held on March 16, 1978, to consider whether to execute the Merger Agreement with Unilever U.S.

that had been finalized and approve the preliminary drafts of the proxy statement that had been prepared for use in soliciting shareholder approval once the ruling from the Internal Revenue Service had been obtained. After Morgan Stanley updated its previous reports by informing the Board of Directors that it had conducted an investigation to determine whether any change in circumstances had occurred that would cause it to alter its prior conclusion and found no such change, the Board of Directors approved the execution of the Merger Agreement. Copies of the following items relating to the March 16, 1978, NSC Board Meeting are attached as exhibits as indicated:

Description	Exhibit
Minutes of Meeting of Petitioner's Board of Directors held 3/16/78 (w/various draft agreements attached)	19-S

26. As indicated in paragraph 8 above, on June 28, 1978, the IRS issued a favorable ruling regarding the transaction as proposed. On the same day, the Executive Committee of Petitioner's Board of Directors met in special session and resolved that a Special Stockholder's Meeting be held on August 15, 1978, to vote on the Merger Agreement.

27. Prior to submission of its written opinion for inclusion in the proxy materials, the Morgan Stanley project team sought further internal review of its findings from its Mergers & Acquisitions Review Committee. A copy of a Morgan Stanley memorandum dated July 7, 1978, from the project team to the Mergers & Acquisitions Review Committee is attached as Exhibit L. Petitioner stipulates only that Exhibit L is an

authentic copy of a document prepared by Morgan Stanley but does not stipulate as to the truth of the contents thereof and reserves all other evidentiary objections. The Review Committee approved the team's findings and authorized the delivery of Morgan Stanley's written opinion to Petitioner's Board of Directors.

28. On July 10, 1978, a Special Meeting of Petitioner's Board of Directors was held. At the meeting Mr. Greenhill updated the firm's prior reports and delivered a Morgan Stanley letter dated July 10, 1978 (a copy of which is attached as Exhibit 20-T), expressing its opinion on the fairness of the proposed Unilever U.S. offer to Petitioner's shareholders (the "fairness opinion"). Such letter was distributed to Petitioner's shareholders with the Proxy Statement (a copy of which is attached as Exhibit 21-U) for the meeting of Petitioner's shareholders mentioned in paragraph 10 below. A copy of the minutes of the July 10, 1978, meeting of the Board of Directors is attached as Exhibit 22-V.

29. In arriving at its fairness opinion, Morgan Stanley had undertaken a thorough review and analysis of Petitioner's business operations, financial results and future prospects, which it periodically updated as indicated in paragraphs 22, 24, 25 and 27 above. It studied, among other things, Petitioner's consolidated historical and current earnings, cash flow, dividends and book value; it reviewed and analyzed internal financial projections and discussed the business and prospects of Petitioner with its management; and it visited certain of Petitioner's facilities. Morgan Stanley also reviewed and analyzed published information of certain other companies,

compared Petitioner from a financial perspective with those other companies and reviewed and analyzed the terms of comparable acquisitions. It also reviewed the stock market trading price range of Petitioner's common stock for a six-year period and compared such data with statistics for other comparable companies and with market indices. In addition to evaluating Petitioner, Morgan Stanley reviewed and analyzed the business operations, financial results and future operations of Unilever U.S. and its subsidiaries and discussed those matters with their management.

30. On August 15, 1978, a special meeting of Petitioner's shareholders was held at which the merger portion of the transaction was approved by a vote of the shareholders (represented in person or by proxy) of 5,587,672 "for" and 23,065 "against". A copy of the minutes of such meeting is attached as Exhibit 23-W. Pursuant to a letter agreement dated March 16, 1978 (a copy of which is attached as Exhibit 24-X), Mr. Greenwall and his wife voted their shares of Petitioner's common stock for and against adoption of the Merger Agreement in the same ratio as the ratio of the votes cast by the other shareholders of Petitioner. Later the same day, there was a closing of both parts of the transaction pursuant to the Exchange Offer and the Merger Agreement. Morgan Stanley attended the shareholders' meeting and, in connection with the closing, advised Petitioner that there had not been any change in circumstances that would warrant Petitioner's Board of Directors' resolving not to proceed with the transaction.

31. During the course of the closing, the Certificate of Merger was filed with the Delaware Secretary of State along with revisions in Petitioner's Certificate

of Incorporation and the Certificate of Incorporation of Holding. Thereafter Petitioner notified the New York Stock Exchange that its stock was no longer to be listed for public trading.

32. Morgan Stanley charged Petitioner a fee in the amount of \$2,200,000 for the services rendered by it to Petitioner and its Board of Directors in connection with the acquisition of Petitioner's stock by Unilever U.S., plus out-of-pocket expenses of \$7,586.23 and the legal fee of Morgan Stanley's counsel (Davis Polk & Wardwell) in the amount of \$18,000. A copy of a Morgan Stanley invoice to Petitioner dated August 23, 1978, for its services in the matter is attached as Exhibit 25-Y. Such fee of \$2,200,000 was based principally on the fee schedule in Morgan Stanley's letter to Petitioner dated December 6, 1977, and was comparable to the amounts that were charged by Morgan Stanley to its clients and by other leading investment banking firms in other corporate acquisitions of a comparable type and magnitude and was reasonable in amount. Lazard charged Unilever U.S. a fee of \$2,400,000 for its services in connection with the transaction.

33. DPL&G charged Petitioner a fee of \$490,000 for the legal services rendered by it to Petitioner and its Board of Directors in connection with the acquisition of Petitioner's stock by Unilever U.S., plus out-of-pocket expenses of \$15,069. Copies of DPL&G invoices (dated March 8, April 6, May 9, September 12 and October 19, 1978) and transmittal letters (dated April 6, May 10 and September 22, 1978) to Petitioner regarding the fees and expenses referred to above are attached as Exhibit 26-Z.

34. In addition to the fees to Morgan Stanley and DPL&G, Petitioner incurred in its 1978 taxable year the following expenses for services rendered to it in connection with the preparation of the Exchange Offer and the Proxy Statement, for the meeting of Petitioner's shareholders held on August 15, 1978, the conduct of such meeting and the consummation of the transaction:

(a) a fee of \$27,841 paid to Main Lafrentz & Co. for preparing certain financial statements and information included in the Exchange Offer and the Proxy Statement, as required by the rules and regulations of the Securities and Exchange Commission ("SEC"), and for meeting with Price Waterhouse & Company, accountants for Unilever U.S., to discuss the accounting practices of both companies and to coordinate those practices for application subsequent to the closing of the transaction;

(b) a fee of \$69,234 paid to Ad Press, Ltd. for printing the Exchange Offer, the Proxy Statement and related materials distributed to Petitioner's shareholders;

(c) a fee of \$1,350 paid to the SEC for filing proxy materials in connection with the transaction, as required by SEC rules and regulations;

(d) a fee of \$8,606 paid to Georgeson & Co. for soliciting proxies in connection with the meeting of Petitioner's shareholders. Attached hereto as Exhibit 27-AA is a letter agreement dated April 17, 1978, between Petitioner and Georgeson & Co. together with Georgeson & Co. invoices to Petitioner dated August 23, 1978, August 31, 1978, September 29, 1978, October 10, 1978, and October 30, 1978;

(e) a fee of \$22,903 paid to Morgan Guaranty Trust Company of New York for services rendered as transfer agent, depository and disbursing agent in connection with the transaction and the judge of votes cast at the meeting of Petitioner's shareholders; and

(f) a fee of \$22,903 paid to Towers, Perrin, Forster & Crosby ("TPF&C"). Prior to the transaction, Petitioner had issued both qualified and non-qualified options for the purchase of its common stock to approximately fifty of its executives. Some of the options had not been exercised at the time of the transaction while other such options had been exercised. Petitioner had also issued restricted stock to such executives and certain other employees. Under the terms of the Merger Agreement, all such options were to be canceled and all restrictions on issued stock were to be waived prior to the holders' exchanging the stock in the merger. TPF&C was engaged to develop formulas to compensate the executives involved for any financial disadvantage suffered by reason of the merger. Unilever U.S. reimbursed Petitioner for the costs of the payments to the executives. Petitioner paid TPF&C for developing the formulas upon which the payments to the executives were made. Attached as Exhibit 28-AB is a copy of a TPF&C summary of the payout values and a narrative of the payout calculations.

Each of the foregoing fees was determined at arm's-length, was reasonable in amount and was of a type customarily incurred in connection with transactions such as the acquisition of Petitioner's stock by Unilever U.S.

35. The fees and expenses described in paragraphs 32, 33 and 34 above were paid by Petitioner with its own funds, and Petitioner was not reimbursed therefor by Unilever U.S. or any other party.

36. Attached hereto as Exhibit M is a covering letter and a Chronology of Events between October 7, 1977 and December 1, 1977, prepared on behalf of Petitioner and submitted to the SEC in response to an inquiry by the SEC into the pattern of trading activity in Petitioner's stock during this time period. The SEC inquiry was a routine check. Following the receipt of this information the SEC inquiry was concluded without any action being taken or recommended. Petitioner stipulates only that Exhibit M is an authentic copy but does not stipulate as to the truth of the contents thereof and reserves all other evidentiary objections.

37. With respect to those instances referred to in Exhibit M where DPL&G rendered advice to Frank K. Greenwall regarding his personal tax situation it is stipulated that any time charges relating to such personal tax advice were billed to and paid directly by Mr. Greenwall and not by Petitioner.

38. Prior to the discussion of October 7, 1977, Mr. Rohatyn knew Mr. Greenwall as a result of discussions with Mr. Greenwall concerning a prior proposed transaction. Mr. Rohatyn did not, in connection with the transaction in issue, communicate with Mr. Greenwall regarding any interest Mr. Greenwall might have in selling his stock in Petitioner or Unilever U.S.'s interest in acquiring all of Petitioner's stock until after Unilever U.S. had decided to acquire Petitioner and requested Mr. Rohatyn to initiate discussions pur-

suant to which the meeting on October 7, 1977, was arranged.

39. In its Federal income tax return for its 1978 taxable year, Petitioner deducted the Morgan Stanley fee and expenses described in paragraph 32 above, but did not deduct the DPL&G fee and expenses described in paragraph 33 above or the fees described in paragraph 34 above.

/s/ Leonard E. Kust
Leonard E. Kust

WILLIAM F. NELSON
Chief Counsel
Internal Revenue
Service

CADWALADER, WICKERSHAM & TAFT
100 Maiden Lane
New York, New York 10038
(212) 504-6000

By: /s/ Richard J. Sapinski
Richard J. Sapinski
International Special
Trial Attorney

June 4, 1987

600 Arch St., Rm. 10424
Philadelphia, Pa. 19106

Internal Revenue Service

Department of the Treasury
A:Nwk:NBB:GT:90D

Date: JUN 12 1984

CERTIFIED MAIL

Social Security or

Employer Identification Number:

13-1522451

Tax Year Ended and Deficiency:

August 15, 1978 - \$1,068,281.00

▷ National Starch and Chemical Corporation
10 Finderne Avenue
Bridgewater, New Jersey 08807

Person to Contact:

Noel B. Butler

Contact Telephone Number:

201-645-2212

— Dear Sir or Madam:

We have determined that there is a deficiency (increase) in your income tax as shown above. This letter is a NOTICE OF DEFICIENCY sent to you as required by law. The enclosed statement shows how we figured the deficiency.

If you want to contest this deficiency in court before making any payment, you have 90 days from the above mailing date of this letter (150 days if addressed to you outside of the United States) to file a petition with the United States Tax Court for a redetermination of the deficiency. The petition should be filed with the United States Tax Court, 400 Second Street NW., Washington, D.C. 20217, and the copy of this letter should be attached to the petition. The time in which you must file a petition with the Court (90 or 150 days as the case may be) is fixed by law and the Court cannot consider your case if your petition is filed late. If this letter is addressed to both a husband and wife, and both want to petition the Tax Court, both must sign the petition or each must file a separate, signed petition. You can get a copy of the rules for filing a petition by writing to the Clerk of the United States Tax Court, at the address shown in this paragraph.

If you decide not to file a petition with the Tax Court, we would appreciate it if you would sign and return the enclosed waiver form. This will permit us to assess the deficiency quickly and will limit the accumulation of interest. The enclosed envelope is for your convenience. If you decide not to sign and return the waiver and you do not timely petition the Tax Court, we will assess and bill you for the deficiency after 90 days from the above mailing date of this letter (150 days if this letter is addressed to you outside the United States).

If you have any questions, please contact the person whose name and telephone number are shown above.

Sincerely yours,

Roscoe L. Egger, Jr.

Commissioner

By

(SIGNED) JOSEPH LEVINE

Enclosures:

Copy of this letter

Statement

Waiver

Envelope

Newark Appeals Office

970 Broad St., Room 702, Newark, NJ 07102

Associate Chief,

Appeals Office

Letter 894(RO) (Rev. 4-82)

Notice of Deficiency-Waiver

A:Nwk:NBB:GT:90D

Name, SSN or EIN, and Address of Taxpayer(s)

National Starch and Chemical Corporation
10 Finderne Avenue
Bridgewater, New Jersey 08807

Kind of Tax

Income



Copy to Authorized Representative

Mr. Leonard E. Kust and Mr. Geoffrey R.S. Brown
c/o Cadwalader, Wickersham & Taft
One Wall Street, New York, New York 10005

Tax Year Ended

Increase in Tax

Deficiency

Penalties

August 15, 1978

\$1,068,281.00

See the attached explanation for the above deficiencies

I consent to the immediate assessment and collection of the deficiencies (increase in tax and penalties) shown above, plus any interest provided by law.

Your
Signature



(Date signed)

Spouse's Signature,
If A Joint Return
Was Filed



(Date signed)

Taxpayer's
Representative
Sign Here



(Date signed)

Corporate
Name:

Corporate
Officers
Sign Here



(Signature)

(Title)

(Date signed)



(Signature)

(Title)

(Date signed)

Note:

If you consent to the assessment of the amounts shown in this waiver, please sign and return it in order to limit the accumulation of interest and expedite our bill to you. Your consent will not prevent you from filing a claim for refund (after you have paid the tax) if you later believe you are entitled to a refund. It will not prevent us from later determining, if necessary, that you owe additional tax; nor will it extend the time provided by law for either action.

If you later file a claim and the Internal Revenue Service disallows it, you may file suit for refund in a district court or in the United States Claims Court, but you may not file a petition with the United States Tax Court.

Who Must Sign

If this waiver is for any year(s) for which you filed a

joint return, both you and your spouse must sign the original and duplicate of this form. Sign your name exactly as it appears on the return. If you are acting under power of attorney for your spouse, you may sign as agent for him or her.

For an agent or attorney acting under a power of attorney, a power of attorney must be sent with this form if not previously filed.

For a person acting in a fiduciary capacity (executor, administrator, trustee), file Form 56, Notice Concerning Fiduciary Relationship, with this form if not previously filed.

For a corporation, enter the name of the corporation followed by the signature and title of the officer(s) authorized to sign.

If you agree, please sign one copy and return it; keep the other copy for your records.

Form 5278 (Rev. May 1982)	Department of the Treasury - Internal Revenue Service Statement — Income Tax Changes	Return Form 1120	Schedule No. 1
Name(s) of Taxpayer(s) NATIONAL STARCH AND CHEMICAL CORPORATION		<input checked="" type="checkbox"/> Notice of Deficiency <input type="checkbox"/> Other (specify) _____ <input type="checkbox"/> Settlement Computation	
		Tax Years Ended	
1. Adjustments to income		August 15, 1978	
a. See Schedule 4549-B Attached		\$ 1,779,241	
b.			
c.			
d.			
e.			
f.			
g.			
2. Total adjustments		1,779,241	
3. a. <input checked="" type="checkbox"/> Taxable income <input type="checkbox"/> Adjusted gross income			
b. As shown in: <input type="checkbox"/> Tax table income			
<input type="checkbox"/> Preliminary letter dated _____ <input type="checkbox"/> Notice of deficiency dated _____ <input checked="" type="checkbox"/> Return as filed		15,544,764	
4. <input checked="" type="checkbox"/> Taxable income as revised <input type="checkbox"/> Tax table income as revised		17,324,005	
5. Tax from <input type="checkbox"/> Tax tables <input type="checkbox"/> Tax rate schedules			
6. Alternative tax if applicable (from page <u>5</u>)		8,299,525	
7. Corrected tax liability (lesser of line 5 or 6)		8,299,525	
8. Less credits (specify)	a. Foreign Tax Credit	723,808	
	b. Investment Credit	448,557	
	c.		
9. Balance (line 7 less amounts on lines 8a through 8c)			
10. Plus	a. Tax from recomputing prior year investment credit	7,127,160	
	b. Self-employment tax	582	
	c.		
11. Total corrected income tax liability (line 9 plus amounts on lines 10a through 10c)		7,127,742	
12. Total tax shown on return or as previously adjusted Assessment 4-20-84		257,444	
		5,802,017	
13. Increase or (decrease) in tax (difference between lines 11 and 12)		\$ 1,068,281	
14. Additions to the tax (listed below)			

EXPLANATION OF ITEMS

SCHEDULE NO. OR
EXHIBIT

1(a)

NAME OF TAXPAYER

NATIONAL STARCH AND CHEMICAL CORPORATION

YEAR/PERIOD ENDED

August 15, 1978

(a) It is determined that the payment of \$2,225,586.00 to Morgan Stanley and Company, Incorporated and taken on your return as a deduction for professional advisory fees represents a capital expenditure and, therefore, not deductible as an ordinary and necessary business expense. Accordingly, your taxable income is increased \$2,225,586.00 for year ended August 15, 1978.

(b) Thru (n) and foreign tax credit - Adjustments in accordance with explanations and schedules previously furnished to which you have agreed.

Department of the Treasury
Internal Revenue Service

▶ **Attach to your income tax return.**

1978

Name _____

NATIONAL STARCH AND CHEMICAL CORPORATION

Employer Identification Number
13-1522451

[illegible][illegible]

7 Enter excess of net short-term capital gain (line 3) over net long-term capital loss (line 6)		
8 Enter excess of net long-term capital gain (line 6) over net short-term capital loss (line 3)	13,873	
9 Total of lines 7 and 8. Enter here and on Form 1120, line 9(a), page 1	13,873	

(Fiscal year corporations, do not complete Schedule D (Form 1120), Part IV but instead complete Form 1120-FY (1978-79))

10 Taxable income (Form 1120, line 30, page 1)	17,324,005
11 Excess of net long-term capital gain over net short-term capital loss	13,873
12 Subtract line 11 from line 10	17,310,132
13 Enter line 12 or \$25,000, whichever is less. (Members of a controlled group enter one-half of surtax allocation, see instructions)	25,000
14 Subtract line 13 from line 12	17,285,132
15 Enter line 14 or \$25,000, whichever is less. (Members of a controlled group enter one-half of surtax allocation, see instructions)	25,000
16 Subtract line 15 from line 14	17,260,132
17 20% of line 13	5,000
18 22% of line 15	5,500
19 48% of line 16	8,284,863
20 30% of line 11	4,162
21 Alternative tax—total of lines 17 through 20. If applicable, enter here and on Form 1120, line 9, Schedule J, and write "ALT." in the margin to the right of the entry	8,299,525

[Exhibit 3-C]

Dear Friends:

Sales and earnings reached record levels in 1978 for the 26th consecutive year, except for earnings in 1969. Sales were up 13.0 percent over 1977 and earnings were up 14.4 percent. In many areas, earnings were adversely affected by lower operating margins resulting from the pressures of inflationary increases in raw material and other costs against competitive selling prices. Earnings were favorably affected, however, by substantial improvement in the sales and margins of joint ventures and by balance sheet translation gains.

Research and development and related technical activities continued to increase in 1978 throughout all phases of our operations. Our research and development activities incurred expenses for the year 1978 that amounted to \$7.4 million.

Our research and development efforts in 1978 have continued as productive as ever judging by the number of patents filed, new and improved products developed, new markets found, new processes developed and the steady advance of earlier development projects to commercial status. Many of these accomplishments will be mentioned in the latter pages of this report, but we do want to emphasize that it is this continuing flow that gives us confidence in our future growth.

Also important in our pattern of growth, our work on acquisitions has continued through the year. Our goal in acquisitions and joint ventures is to seek footholds in new but related areas, or to expand more rapidly in areas where we are established or have

made a commitment and a start. For example, during the year we acquired a small operation in Detroit, Mich., which strengthens the position of our Bondmaster Department in the automotive field by giving us established contacts and new approved product sealants and adhesives for this market.

Other examples are the acquisition of Leland Chemical Company at Leland, N.C., and the technology and business of Haven Chemical Company, Philadelphia, Penn. Leland gives us additional capacity and new technology for high pressure reactions, as well as some established sales of cosmetic and pharmaceutical intermediates. Haven provides us with an additional line of specialty monomers for sales to the plastics, rubber and fiber industries. While they are small operations, they represent a natural addition to and extension of Proctor Chemical Company operations.

In another area, we have acquired Dycol Chemical Company, a small company processing and marketing guar gum. National has long had an interest in entering the natural gum market, and the acquisition of Dycol represents our first venture. Guar gum, because of its special properties, is marketed as a water retention aid in oil well muds, textile printing and for other uses and applications with which National is familiar. We are in a position to apply and use our specialty polymers derivatization technology to develop new guar products for these markets as well as for other markets where it is anticipated that guar products can be used.

In still another area, early in 1979 we purchased certain operations of Bear Hybrid Seed Company relating to the breeding and production of specialty

corn hybrid seeds. Bear has been the sole producer of high amylose hybrid corn seed which is the basis for an important segment of National's starch sales to the corrugating industry and of certain starches sold to the food industry. In addition, Bear has been a producer of waxy hybrid seed, the basis for the waxy corn which is a major raw material for our starch operations. This acquisition will be combined with our Customaize operation in order to produce better agronomic strains of specialty hybrid seeds, as well as to develop strains with higher levels of starch and possibly different types of starch.

Capital expenditures in 1978 reached a new all-time high of over \$35 million, up substantially from \$15.7 million in 1977 and an annual average of \$18.3 million in the 1974-1976 period. This increased level of investment reflects the growth of our volume in specialty starches, hot-melt adhesives, resin emulsions and in specialty chemicals at Proctor Chemical Company. It will also relieve some inefficiencies suffered during 1978 as a result of operating at higher than optimum production levels.

While 1978 expenditures were spread over many projects, by far the largest multi-million dollar expenditure was for Phase I of the expansion of our corn grinding and specialty starch capacity at Indianapolis, Ind., which is essentially completed. Other important projects were a new, more efficient Permabond plant to produce cyanoacrylate adhesives in Bridgewater, N.J., a semi-works plant in Salisbury, N.C. for the production of PERMASORB®, our high water absorbing polymer, an expanded resin facility at Meredosia, Ill., to be completed in early 1979 and a number of

facilities and equipment installations for specialty chemicals at Proctor.

We anticipate one more year of unusually high capital expenditures in 1979 in order to complete the round of capacity expansions currently under way. Major items will be the completion of Phase I at Indianapolis and the initiation of Phase II, still more resin emulsion and hot-melt adhesives capacity, and expansion of our Process Development facility at Plainfield, N.J.

Investments required to meet environmental regulations represent between 5 percent and 7 percent of our total capital investment, and will undoubtedly increase as will the cost of their operation. We are concerned with these ever stricter requirements and question in many cases that the levels of risk justify the extremely high standards being set by regulatory agencies. Nevertheless, we have done our best to meet all such standards and anticipate no serious problems in continuing to do so.

On this subject, it is worthy of mention that our research and development have provided specialty industrial products, starches, resins and adhesives which make a contribution to our customers' operations by reducing air and water pollution and at the same time improving yields, efficiency and safety.

It is a firm part of our philosophy to practice equality of opportunity in our employment practices and to provide for the health and safety of our employees and the people who use our products. We should mention that 1978 again proved to be a year of considerable progress in plant safety with two-thirds

of our domestic locations showing gains in measured performance.

Plants throughout the company have introduced new energy conservation measures as part of an ongoing program. Every six months we calculate the energy used to produce a pound of product for the preceding twelve-month period. Steam generating systems are now more efficient and our dust and fume removal systems now use less energy.

In August 1978, upon the completion of the Unilever merger, a number of previously planned management changes were effected. Frank K. Greenwall, formerly Chairman of the Executive Committee, became Chairman of the Finance Committee, and Donald D. Pascal, formerly Chairman of the Board, became Chairman of the Executive Committee. In succession and together, Messrs. Greenwall and Pascal have directed our company's affairs for a great many years and have provided the leadership for the record growth we have enjoyed. Their continued participation provides an important contribution to our management.

Carlyle G. Caldwell, formerly President, became Chairman of the Board, continuing as Chief Executive Officer, and Wallace K. Grubman, previously Group Vice President, became President and Chief Operating Officer.

As anticipated, the merger with Unilever has not affected our organization or our real work of providing ever more and better service to our customers. We will benefit greatly from the availability of Unilever's enormous resources, especially in the area of basic technology.

We are most pleased that our four outside directors continue their full interest in National even though we are no longer a public company.

To all employees, it bears repeating that National is people. National's style, its character, its relationship with customers and suppliers, and with our associated companies, remains unchanged. Our will and ability to achieve our goals are derived from dedicated people who take great pride in our company's continued progress and achievement.

Even though we seem to live and work in an ever more complex world, we have every confidence that we will successfully meet the challenges of 1979 and the years ahead.

Many thanks to all who have contributed to our growth.

Carlyle G. Caldwell
Chairman of the Board and
Chief Executive Officer

Wallace K. Grubman
President and
Chief Operating Officer

1978

What the Future Holds

It is certainly easier to write about the future in the light of another successful year in 1978. Not that the future is easy to see, but certainly in a world in which technology is so dynamic, the future is bound to hold many opportunities, as well as some surprises.

Short run, of course, we find ourselves enjoying a relatively good economic climate and while some near future hesitation may occur, hopefully, it will be short-lived and not too disabling. Even in good circumstances, however, we find our progress unnecessarily hampered by two outstanding road blocks—inflation and over-regulation by governments. Anything we can do as private citizens to bring about reduced government spending and smaller budget deficits will do much to enhance the results of our business and our personal efforts.

What does the past tell us about the future? What have been the strengths which have made us grow over the last 25 years by 15 times in sales and by more than 20 times in before-tax profits and net worth?

Our number one asset by far is our people, who are well-trained, experienced and acknowledged as leaders in their respective fields.

National's innovations over the years attest to these qualities and to their diligence and ability to work hard as a well-coordinated team. We have plowed back our earnings into fully equipped and sophisticated plants and laboratories. We have located ourselves in growing markets around the world

and have created products with a great diversity of growing end uses.

Technology, both in the laboratory and in our customers' plants, has spearheaded our ability to serve these markets with innovative products and new concepts. We have a great reservoir of knowledge and experience with which to continue to find new ways to solve the problems which beset our customers, in a never-ending stream of opportunities for National.

This past year we became associated with Unilever, a major worldwide company with principal interests in the food and detergent areas. Their policy permits us to continue the business philosophies and practices which have promoted our past growth and, at the same time, provides new opportunities and resources.

So, putting it all together, everything points to a company with both the tools and the markets to continue and, hopefully, to expand a long-standing pattern of growth. There will be obstacles, of course. Some technological developments, as always, will be unfavorable and, as mentioned, government regulations and overspending remain problems. While we cannot discount such developments, we can make sure that they have only a minimal effect on the course of our progress.

The opportunities to help direct National's operations and the consequent rewards and promotions will go, of course, to those who successfully keep us on track.

Donald D. Pascal
Chairman of the
Executive Committee

[Exhibit 12-L]

MORGAN STANLEY & CO.
Incorporated
1251 Avenue of the Americas
New York, N.Y. 10020

December 6, 1977

Mr. Donald D. Pascal
Chairman of the Board
National Starch and Chemical Corporation
10 Finderne Avenue
Bridgewater, New Jersey 08807

Dear Mr. Pascal:

In connection with our proposed assignment from National Starch and Chemical Corporation I am writing to provide a detailed description of our approach to matters of this nature. I have also provided a brief review of the Merger and Acquisition Department of Morgan Stanley and a summary of Morgan Stanley's fee schedule for assignments of this size and scope. We understand that National Starch is interested in having Morgan Stanley review its strategic alternatives within the context both of the longer term situation of a 15% equity ownership in National Starch which at some point will be transferred from its present individual "founding" owners and of an evaluation of an immediate proposed business combination involving Unilever.

The special requirements for planning and executing merger and acquisition assignments were recognized by Morgan Stanley many years ago. These requirements, coupled with increased demand for acquisition services by our clients, evolved in 1971 into

MORGAN STANLEY & CO.*Incorporated*

a major commitment on the Firm's part to these activities. Morgan Stanley now has a separate, full-time Merger and Acquisition Department within the Firm, headed by two Managing Directors and supported by four Vice Presidents, eight associates and eight Research Analysts. In addition, officers and staff from other areas of the Firm augment the assignments managed by the Department when special skills or manning are required. Major valuation judgments or strategic matters are considered by a larger group of officers from various functional areas of the Firm so that advice rendered to a client represents a consensus judgment of a broad and experienced group.

While a major portion of our assignments have involved representation of acquirors, we have considerable experience in representing acquirees. For example, we represented Otis during its acquisition by United Technologies as well as finding buyers for LaTerre Co., Inc., Pan Ocean Oil Corporation and Burmah Oil Incorporated which were sold to Tenneco, Marathon Oil and R. J. Reynolds, respectively. Currently, among projects which are of public record, we are advising Franklin Life in connection with its acquisition by American Brands, we are assisting Babcock & Wilcox Company relating to its acquisition by J. Ray McDermott & Co., Inc. as well as Carborundum Company in the proposed acquisition by Kennecott Copper Corporation.

MORGAN STANLEY & CO.
Incorporated

At the present time we envision that our assignment from National Starch would involve several phases:

Preliminary Analysis. Initially, we would conduct a detailed investigation and analysis of National Starch and Chemical Corporation with a view toward understanding its business and its stockholders. In connection with reviewing National Starch's situation, we understand that approximately 15% of the common stock is beneficially owned by Mr. and Mrs. Greenwall, aged 81 and 79, respectively.

Review of Alternatives. The results of this analysis coupled with our active involvement with a number of major industrial companies and our understanding of their acquisition criteria would allow us to judge the realistic alternatives available to National Starch both as to price and structure of a transaction with another company. Within the framework of the alternatives available we would then be in a position to evaluate the structure and value of a possible combination with Unilever.

Valuation. A crucial part of our role in this type of assignment is our valuation of the client company. A valuation judgment is based upon, in part, an extensive study of the financial and operating record of National Starch (including a comparison of the company's performance relative to other companies with similar lines of business), the relative market performance of the company's securities, a study of the capitalization of the company, an investigation of the terms of acquisitions of companies of a comparable