WILLKIE FARR & GALLAGHER LLP

CLIENT MEMORANDUM

SEC FINDS INVESTMENT ADVISER OVERVALUED MORTGAGE-BACKED SECURITIES AND ENGAGED IN PROHIBITED CROSS-TRADES

The Securities and Exchange Commission (the "SEC") has focused on mutual funds' valuation of portfolio holdings during the recent financial crisis. As part of this focus, the SEC last week filed an administrative proceeding against Evergreen Investment Management Company, LLC (the "Adviser") and its affiliated broker-dealer, Evergreen Investment Services, Inc. (the "Distributor"), which settled the SEC proceeding and the parallel proceeding brought by the Massachusetts Securities Division by, among other things, agreeing to a payment of more than $40 million.[1] The settlement arises from allegations that the value of mortgage-backed securities held by the Evergreen Ultra Short Opportunities Fund (the "Ultra Fund" or the "Fund") was overstated. The SEC alleged that the Ultra Fund overstated its net asset value ("NAV") per share by as much as 17% as a result of a number of improper valuation practices from February 2007 through June 2008. In addition, the SEC alleged that the Adviser and the Distributor improperly provided some investors with selective information about the overstated valuation (allowing them to redeem earlier than other investors) and caused the Ultra Fund to engage in prohibited cross-trades with affiliated mutual funds.

Valuation of the Ultra Fund

The Ultra Fund's prospectus stated that the Fund would generally value its portfolio securities at market value. If the market value for a security was not readily available or was deemed unreliable, that security could be valued at "fair value." The Ultra Fund's valuation procedures provided that securities could be fair-valued by one of three sources, in order of preference: (1) third-party pricing vendors; (2) third-party broker-dealers; and (3) the Fund's portfolio management team.

The SEC alleged that, despite the Ultra Fund's procedures, the Fund used other valuation methods for certain securities even where third-party pricing vendor prices were available, and also that the portfolio management team withheld relevant negative information from the Adviser's Valuation Committee. The SEC alleged numerous errors in the pricing provided by the portfolio management team, including that:

- The portfolio management team recommended valuations based on prices provided by an individual broker-dealer in Florida (even when the third-party pricing vendor had reduced prices), whose method for determining prices had not been previously reviewed or approved by the Valuation Committee.

[1] Evergreen Inv. Mgmt. Co., LLC, Exchange Act Release No. 60,059 (June 8, 2009).

- The portfolio management team withheld from the Valuation Committee information concerning another Evergreen mutual fund's purchase of a collateralized debt obligation backed by subprime residential mortgages for $9.50 per share while the Ultra Fund valued the security at $98.93 per share.[2]

- The portfolio management team failed to disclose information that a certain collateralized debt obligation owned by the Ultra Fund would not receive any additional cash flow until the senior tranche of the security was paid in full.

Due to these pricing errors, various securities were re-priced. For example, after the Valuation Committee learned that the portfolio management team was using a Florida broker-dealer to price a significant portion of the Ultra Fund's portfolio holdings and that considerably less due diligence was being conducted on that broker-dealer than on other pricing sources, 15 of the 16 securities valued based on prices provided by the Florida broker-dealer were re-priced downward in June 2008. Ten of those 15 securities had been overvalued for at least eight months and eight of those securities were re-priced by more than 90%.

The SEC also alleged that the Adviser did not properly consider readily-available negative information in the valuation process for certain mortgage-backed securities held by the Ultra Fund when making its recommendations to the Valuation Committee. Specifically, the SEC noted that the Ultra Fund failed to consider the following:

- That a benchmark index, which served to measure the riskiness of residential mortgage-backed securities, had substantially weakened, with the sector on subprime securities reaching record lows.

- The default and delinquency rates of subprime mortgages that served as the backing for the Fund's holdings of collateralized debt obligations.

The SEC alleged that as a result of these valuation issues, the Ultra Fund appeared to be performing better than it actually was from February 2007 to June 2008. Had the valuations been correct, the Ultra Fund would have been ranked by a national ranking firm near the bottom, and not the top, of its fund category for performance. Therefore, investors that redeemed their shares received more money per share than they should have, and those that purchased shares paid more money per share than they should have in that period. In particular, the SEC alleged that the Ultra Fund, the Adviser and the Distributor, as applicable, violated (1) Section 206(2) of the Investment Advisers Act of 1940 (the "Advisers Act") in committing a fraud or deceit by providing an overstated NAV to the Ultra Fund so that higher advisory fees were paid to the

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[2] Upon learning of the transaction, the Ultra Fund's portfolio management team inquired whether the sale was "distressed," and therefore could be disregarded for purposes of valuing the security. Despite a response to the contrary, the portfolio management team failed to disclose this negative information and instead informed the Valuation Committee that the team believed that the sale was distressed.

Adviser and (2) Rule 22c-1(a) under the Investment Company Act of 1940 (the "Investment Company Act") in selling and redeeming shares at prices not based on NAV due to the overstated nature of the Ultra Fund's NAV.

Disclosure of Material, Nonpublic Information to Selected Investors

In addition to inflating the value of the Ultra Fund's holdings, the SEC alleged that the Adviser and the Distributor disclosed information regarding the re-pricing of the NAV of the Ultra Fund only to certain shareholders, giving them an unfair advantage over other shareholders of the Ultra Fund. On June 11, 2008, after learning about previously undisclosed negative information regarding the valuation of securities, the Valuation Committee began to re-value securities owned by the Ultra Fund in accordance with prices provided by a third-party pricing vendor. Almost all of those prices were lower than the previous valuations, thus reducing the Ultra Fund's NAV by $0.12 to $8.83 per share.

In anticipation of inquiries about decreases in the Ultra Fund's NAV, the Distributor requested and received material, nonpublic information from the Adviser in order to respond to any potential questions about the re-pricing of the Ultra Fund's NAV. The Adviser and the Distributor provided information about the re-pricing to a limited number of shareholders or their financial intermediaries, including customers of affiliates, instead of releasing the information to all shareholders of the Ultra Fund. Many of the shareholders that received the information redeemed their shares before further re-pricings of the securities, which diluted the net asset value per share of the Fund's remaining assets.

As a result of this disclosure, the SEC alleged that the Adviser violated Section 206(2) of the Advisers Act because it knew, or should have known, that the selective disclosures would lead to substantial redemptions before further re-pricings, resulting in the dilution of the Ultra Fund. For similar reasons, the Distributor was also charged with a violation of Section 206(2) for its assistance in providing selective disclosures. The SEC also alleged that during the relevant period, neither the Adviser nor the Distributor established, maintained or enforced written policies and procedures reasonably designed to prevent this type of misuse of material, nonpublic information as required by Section 15(f) of the Securities Exchange Act of 1934 and Section 204A of the Advisers Act. In addition, the SEC charged the Adviser with a violation of Section 34(b) of the Investment Company Act because it misrepresented the Ultra Fund's performance and NAV in a registration statement, and thus included untrue statements of material fact in violation of the section.

Prohibited Cross-Trades

The SEC also alleged that the Ultra Fund was involved in prohibited cross-trades with affiliated mutual funds. Although such cross-trades are generally prohibited by Section 17(a) of the Investment Company Act, Rule 17a-7 allows certain cross-trades if, among other things, they are executed at a price equal to the average of the highest current independent bid to purchase the security and the lowest current independent offer to sell that security. The purchases arranged by the Adviser, however, were at a price other than such average. In certain cases, the Ultra Fund's portfolio management team neglected even to obtain the price information necessary to calculate the average. In addition, the SEC alleged that the cross-trades were made through one or more broker-dealers that received compensation in connection with these transactions, in violation of Rule 17a-7.

Settlement

In settling the proceeding, the Adviser and the Distributor consented to the entry of a cease and desist order by the SEC and agreed to retain an independent compliance consultant acceptable to the staff of the SEC and the independent trustees of any other Evergreen mutual fund (as the Ultra Fund has been liquidated) to conduct a comprehensive review of, among other things, the Adviser's and the Distributor's procedures, as applicable, on valuation, dissemination of material, nonpublic information and cross-trades. The Adviser and the Distributor also agreed to pay more than $40 million in total as part of the settlement, including $33 million to compensate fund shareholders, $4 million in penalties and $3 million in disgorgement of ill-gotten gains. In addition, they will pay the Massachusetts Securities Division a fine of $1 million.

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If you have any questions concerning the foregoing or would like additional information, please contact Benjamin J. Haskin (202-303-1124, bhaskin@willkie.com), Y. Rachel Kuo (202-303-1288, rkuo@willkie.com), or the attorney with whom you regularly work.

Willkie Farr & Gallagher LLP is headquartered at 787 Seventh Avenue, New York, NY 10019-6099 and has an office located at 1875 K Street, NW, Washington, DC 20006-1238. Our New York telephone number is (212) 728-8000 and our facsimile number is (212) 728-8111. Our Washington, DC telephone number is (202) 303-1000 and our facsimile number is (202) 303-2000. Our website is located at www.willkie.com.

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