The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 10639

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SEC STAFF POSITION CONCERNING INDEMNIFICATION OF INDEPENDENT DIRECTORS WHO ARE REMOVED FROM OFFICE

1 Section 17(h) prohibits contractual provisions that protect a director or officer of a company from liability by reason of willful misfeasance, bad faith, gross negligence or reckless disregard of duties as a director or officer ("disabling conduct"). 2 See The Yacktman Funds, Inc. (pub. avail. December 18, 1998). 3 The independent directors included three directors who were not interested persons of the fund as defined under Section 2(a)(19) of the Investment Company Act and one director who was an interested person solely by reason of being an officer of the fund, but who was not affiliated with the fund's adviser. [10639] January 12, 1999 TO: DIRECTOR SERVICES COMMITTEE No. 2-99 SEC RULES MEMBERS No. 4-99 RE: SEC STAFF POSITION CONCERNING INDEMNIFICATION OF INDEPENDENT DIRECTORS WHO ARE REMOVED FROM OFFICE

_____ The SEC staff issued a letter confirming that it would be consistent with Section 17(h) of the Investment Company Act of 19401 for independent counsel selected to render an opinion on the advancement of legal expenses to certain fund directors to afford those directors a rebuttable presumption that they did not engage in "disabling conduct."2 Counsel to a mutual fund requested the SEC staff's guidance in the context of a proxy contest between the fund and its investment adviser involving the composition of the fund's board of directors. The independent directors3 were concerned that they might be sued individually, during or after their tenure as directors, for actions they took on behalf of the fund while directors. Specifically, using fund assets, they solicited proxies in opposition to the adviser and defended themselves in litigation initiated by the adviser. According to the letter to the SEC, the independent directors believed that they were acting in the best interest of the fund shareholders. Each of the independent directors had entered into an indemnification agreement with the fund. The SEC has previously stated that payment of expenses pursuant to an indemnification provision is permissible if the director agrees to repay the advance if indemnification is later disallowed and one of several conditions is met. One of these conditions is that the fund receives an opinion of independent counsel stating that there is reason to believe that indemnification ultimately would be available. Fund counsel in the present case argued that this determination would be difficult to make in the context of a proxy contest. The SEC staff agreed and concluded that it would be appropriate to permit independent counsel to proceed under a rebuttable presumption that directors who are not interested persons of the fund did not engage in disabling conduct in connection with actions that were taken in their capacity as directors and that they believed to be in

the best interests of the fund and its shareholders. The staff added that the same presumption could be made with respect to a director who is an interested person of the fund solely by reason of being an officer of the fund. Copies of the letter from fund counsel to the SEC and the staff’s response are attached. Marguerite C. Bateman Associate Counsel Attachment Note: Not all recipients of this memo will receive an attachment. If you wish to obtain a copy of the attachment referred to in this memo, please call the Institute's Library Services Division at (202)326- 8304, and ask for this memo's attachment number: 10639.
