

MEMO# 2806

May 29, 1991

SUPREME COURT OVERTURNS DECISION IN FUND PROXY CASE

May 29, 1991 TO: BOARD OF GOVERNORS NO. 36-91 SEC RULES COMMITTEE NO. 30-91 RE:
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The U.S. Supreme Court has overturned the decision of the Court of Appeals for the Seventh Circuit that abolished the "futility" exception to the requirement that shareholders make a demand upon directors before proceeding with a derivative suit. (The futility exception excuses demand where, because of bias or otherwise, it can be shown that the board would be unwilling to proceed with the suit directly.) The issue arose in the case of a fund shareholder who had filed a derivative suit alleging that the fund's proxy statement was misleading. (Kamen v. Kemper Financial Services, Inc.) The Seventh Circuit had affirmed the dismissal of the claim on the grounds that the plaintiff had failed to make a demand on the directors. The Institute filed an amicus curiae brief with the Supreme Court, urging the decision be upheld. (See Memorandum to Board of Governors No. 14-91 and SEC Rules Committee No. 12-91, dated February 22, 1991.) In reversing the lower court's decision, the Supreme Court held that the Seventh Circuit was required to defer to state law in resolving the issue unless the state law was inconsistent with the policies of the federal securities laws. In this case, the Court rejected the argument that the statutory duties of independent directors under the Investment Company Act would be undermined by the futility exception. A copy of the Supreme Court's decision is attached. The case has been remanded to the lower courts. We will keep you informed of developments. Craig S. Tyle Associate General Counsel
Attachment