

MEMO# 10673

January 26, 1999

COURT DISMISSES COMPLAINT IN CASE CHALLENGING DIRECTOR INDEPENDENCE

1 Migdal v. Rowe Price-Fleming, et al., Case No. AMD 98-2162 (January 20, 1999). 2 See Gartenberg v. Merrill Lynch Asset Management, 694 F.2d 923, 927-30 (2d Cir. 1982). 3 The plaintiffs' complaint had alleged that the independent directors were "interested persons" because they were "affiliated persons". However, the definition of "affiliated person" under Section 2(a)(3) does not make any reference to service on multiple boards or receipt of fees for doing so. In their motion to dismiss the complaint, the defendants presumed that plaintiffs may be arguing that the directors were "affiliated persons" because they were "controlled persons" under Section 2(a)(3)(C). The definition of "control" in Section 2(a)(9) includes a rebuttable presumption that natural persons are not controlled persons. [10673] January 26, 1999 TO: BOARD OF GOVERNORS No. 4-99 CLOSED-END INVESTMENT COMPANY MEMBERS No. 6-99 DIRECTOR SERVICES COMMITTEE No. 4-99 SEC RULES MEMBERS No. 12-99 RE: COURT DISMISSES COMPLAINT IN CASE CHALLENGING DIRECTOR INDEPENDENCE

The United States District Court for the District of Maryland has issued an order dismissing a complaint against two funds, their advisers, underwriter and transfer agents, and the funds' directors.¹ The Amended Complaint alleged breach of fiduciary duty under Section 36(b) of the Investment Company Act of 1940 (the "Act") against the advisers and other corporate defendants and two derivative claims of breach of fiduciary duty under state law against the directors of the funds. The plaintiffs claimed that the independent directors were co-opted by the advisers, and as a result became "interested persons," through the payment of fees for service on multiple fund boards. By this action, they sought to void all agreements between the funds and the corporate defendants, and recover all fees and expenses paid under the agreements, on the basis that the agreements were not approved by a majority of the independent directors to the funds as required by Section 15(c) of the Act. In granting defendants' motion to dismiss, the court found that an essential element of a Section 36(b) claim was missing; specifically, the Amended Complaint did not allege that the adviser's fee paid by each fund was so excessive that it "could not have been the product of arm's length bargaining."² The court was not convinced that the element of excessiveness under Section 36(b) could be satisfied by an indirect attack on the presumed independence of directors. Moreover, even if the Section 36(b) claim itself was adequate, the court found that the factual allegations in the Amended Complaint were insufficient to rebut the presumption that a natural person is not a "controlled person" under Section 2(a)(9) of the Investment Company Act.³ By dismissing the Amended Complaint without prejudice, the court afforded the plaintiffs the opportunity to file a Second Amended Complaint addressing these deficiencies; however, they must do so prior to February 1, 1999. If they fail to do so, the court will enter a final order dismissing the Section 36(b)

claim with prejudice and the derivative claims without prejudice. A copy of the order is 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: 10673.

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