

MEMO# 11626

February 11, 2000

INSTITUTE FILES AMICUS CURIAE BRIEF IN CASE CHALLENGING CONSTITUTIONALITY OF MARYLAND LAW RELATING TO DETERMINATION OF INDEPENDENT DIRECTORS

1 See Memorandum to Board of Governors No. 26-98, Closed-End Investment Company Members No. 13-98, and SEC Rules Members No. 33-98, dated May 12, 1998. 2 See *Strougo v. Padegs*, 964 F.Supp. 783 (S.D.N.Y. 1997). This decision held that, for purposes of Maryland law, receipt of directors' fees for service on the boards of several investment companies with the same investment adviser called into question the independence on those directors. Based on this ruling, the court excused a plaintiff-stockholder from making a demand on the board of directors of an investment company prior to filing a derivative action challenging a decision by the directors. 3 The members of the Maryland Securities Association are T. Rowe Price, Inc., Ferris, Baker Watts, Incorporated, DB Alex. Brown LLC, and Legg Mason Wood Walker, Incorporated. [11626] February 11, 2000 TO: BOARD OF GOVERNORS No. 8-00 CLOSED-END INVESTMENT COMPANY COMMITTEE No. 4-00 DIRECTOR SERVICES COMMITTEE No. 5-00 SEC RULES COMMITTEE No. 21-00 RE: INSTITUTE FILES AMICUS CURIAE BRIEF IN CASE CHALLENGING CONSTITUTIONALITY OF MARYLAND LAW RELATING TO DETERMINATION OF INDEPENDENT DIRECTORS

As you may recall, in May 1998, the Governor of Maryland signed into law legislation that affirmed for purposes of Maryland corporate law that the Investment Company Act of 1940 governs the determination of whether a director of an investment company is an "interested person."¹ This law was introduced in response to a decision entered by a federal court in May 1997 in the *Strougo* case.² Shortly after the enactment of this new law, its validity was challenged in a suit alleging that it had been enacted in violation of the "single-subject rule" of the Maryland Constitution. (The single-subject rule prohibits amending unrelated provisions onto an existing bill in order to seek the passage of provisions that were added. The provisions of this law had been added to another bill relating to corporations.) In October 1999, the constitutionality of the new law was upheld. The case was then appealed to the Maryland Court of Appeals, where it is currently pending. The Institute, together with the Maryland Securities Association,³ and Alliance Capital Management, as amici curiae, submitted the attached brief urging the Court of Appeals to uphold the lower court's decision. The brief discusses the importance of the new law to investment companies. It notes that pooled or clustered board structures are standard in the industry and help assure efficient and knowledgeable fund governance in accordance with the requirements

of the Investment Company Act. It argues that, were the Maryland law held unconstitutional, this would likely result in investment companies having to consider either re-organizing in a state other than Maryland, or changing their current board structure to avoid the threat of constant litigation. The brief also notes that the decision by the Court of Appeals is likely to have nationwide impact for investment companies and their shareholders inasmuch as Maryland is the jurisdiction of choice for investment companies organized in corporate form. Oral arguments in this matter are currently scheduled for the first week of March. Craig S. Tyle General Counsel Attachment

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