

MEMO# 3069

September 5, 1991

SEVENTH CIRCUIT HOLDS PLAINTIFF IN FUND PROXY CASE WAS REQUIRED TO MAKE DEMAND ON DIRECTORS

September 5, 1991 TO: BOARD OF GOVERNORS NO. 67-91 SEC RULES MEMBERS NO. 44-91
RE: SEVENTH CIRCUIT HOLDS PLAINTIFF IN FUND PROXY CASE WAS REQUIRED TO MAKE DEMAND ON DIRECTORS _____ On

remand from the U.S. Supreme Court, the Court of Appeals for the Seventh Circuit has held that the plaintiff in *Kamen v. Kemper Financial Services, Inc.* was required under Maryland law to make a demand upon the directors of a fund before proceeding with a derivative suit alleging that the fund's proxy statement was misleading. Accordingly, since the plaintiff failed to make such a demand, the court held that the plaintiff's proxy claim was barred. The Seventh Circuit previously had held that the proxy claim was barred because of failure to satisfy the demand requirement. In so holding, the court abolished the "futility" exception to the demand requirement. (The futility exception excuses demand in a derivative suit where, because of bias or otherwise, it can be shown that the board would be unwilling to proceed with the suit directly.) On appeal, the Supreme Court reversed this decision and held that the Seventh Circuit was required to defer to state law (in this case, Maryland, the state of incorporation of the fund) in applying the demand requirement. (The Institute had filed an amicus curiae brief with the Supreme Court, urging that the Seventh Circuit's decision be upheld.) In its decision, the Court of Appeals found that Maryland law generally requires demand, but allows for a futility exception. However, the court found that the plaintiff failed to show that the demand would have been considered futile under Maryland law. The court specifically rejected each of the arguments offered by the plaintiff to demonstrate futility, including that the directors were compensated by the fund, that the directors were "under the control" of Kemper, that the directors participated in the alleged wrongful act by approving the proxy in question and that the directors' subsequent steps to oppose the suit demonstrated the futility of the demand. (With respect to the last point, the court stated: "The argument confuses futility with failure... That the directors disagreed with an argument could show their unwillingness to listen, but also could show that the argument was feeble.") Although the court's holding dismissed the proxy claim, the plaintiff still has a suit alleging excessive management fees under Section 36(b) pending. A copy of the Seventh Circuit's opinion is attached. Craig S. Tyle Associate General Counsel
Attachment

should not be considered a substitute for, legal advice.