

MEMO# 14681

April 29, 2002

THIRD CIRCUIT COURT OF APPEALS AFFIRMS DISMISSAL OF BREACH OF FIDUCIARY DUTY CLAIMS

[14681] April 29, 2002 TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 16-02
DIRECTOR SERVICES COMMITTEE No. 5-02 SEC RULES MEMBERS No. 29-02 RE: THIRD
CIRCUIT COURT OF APPEALS AFFIRMS DISMISSAL OF BREACH OF FIDUCIARY DUTY CLAIMS
The United States Court of Appeals for the Third Circuit recently upheld the dismissal of
claims for breach of fiduciary duty under Section 36(b) of the Investment Company Act of
1940 against the advisers to seven closed-end municipal bond funds.* The plaintiffs,
shareholders in the funds, alleged that the calculation of the advisory fee created greater
incentive to keep the funds leveraged, even when to do so may not have been in the best
interest of shareholders. According to the plaintiffs, the fact that the advisers collected their
fee in the face of such a conflict of interest amounted to a per se breach of their fiduciary
duty. The plaintiffs separately alleged that the conflict of interest created by the fee
arrangement, as well as the issuance of preferred stock in connection with the leveraging
strategy, was not adequately disclosed. Reviewing the case de novo, the court noted that,
under Section 36(b) potential conflicts of interest in mutual fund fee arrangements are not
per se violations of investment advisers' fiduciary duties; an actual breach must be alleged
and proven. In this case, the plaintiffs failed to identify any instance when the advisers
improperly failed to de-leverage the funds in an attempt to maximize their fees.
Furthermore, the plaintiffs failed to allege any actual damages they or the funds suffered as
a result of any improper decision by the advisers. Accordingly, the court concluded that the
plaintiffs did not have a cognizable claim under Section 36(b). The court similarly rejected
the plaintiffs' allegations that the prospectus disclosure concerning the calculation of the
fee was inadequate. It thus affirmed the district court's dismissal of the action. * Green v.
Fund Asset Mgmt., L.P., et al., No. 01-2736 (3rd Cir. April 18, 2002). 2 A copy of the court's
opinion is attached. Marguerite C. Bateman Associate Counsel Attachment Note: Not all
recipients receive the attachment. To obtain a copy of the attachment, please visit our
members website (<http://members.ici.org>) and search for memo 14681, or call the ICI
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