

MEMO# 13657

June 20, 2001

DISTRICT COURT DISMISSES CLAIM UNDER SECTION 36(B) OF THE INVESTMENT COMPANY ACT

[13657] June 20, 2001 TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 21-01 DIRECTOR SERVICES COMMITTEE No. 8-01 SEC RULES MEMBERS No. 50-01 RE: DISTRICT COURT DISMISSES CLAIM UNDER SECTION 36(b) OF THE INVESTMENT COMPANY ACT The United States District Court for the District of New Jersey recently granted defendants' motions for summary judgment and dismissed plaintiffs' claim for breach of fiduciary duty under Section 36(b) of the Investment Company Act of 1940 in a case by shareholders in seven closed-end investment companies (the "Funds") against the Funds, the advisers to the Funds and certain officers of the Funds and the advisers.* The Funds in this case make use of leverage to increase return to shareholders. The calculation of the advisory fee, according to the plaintiffs, created greater incentive to keep the funds leveraged, even when to do so may not have been in the best interest of shareholders. The plaintiffs first 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. Second, the plaintiffs claimed that the fact that the advisers collected their fee in the face of such a conflict of interest amounted to a per se breach of fiduciary duty. In granting defendants' motions for summary judgment, the court rejected both of these claims. The court found that the plaintiffs had failed to meet their burden under Section 36(b) of proving a breach of fiduciary duty. In addition, the court rejected plaintiffs' attempt to impose state law fiduciary duty doctrines under Section 36(b) and disagreed with their contention that the defendants' prospectus disclosure of the method of calculating advisory fees was inadequate. It next found that the officers' receipt of salaries was insufficient to subject them to liability under Section 36(b). Because the plaintiffs had waived any claim that the advisers' fee was excessive, their recovery hinged on a finding that the receipt of compensation in the face of a conflict of interest was per se a breach of fiduciary duty. Although the court declined to limit the application of * *Green v. Fund Asset Mgmt., L.P., et al.*, C.A. No. 97-3502 (DRD)(D.N.J. June 5, 2001). This case dispenses with the only remaining federal claim in this action; the other federal claims had been dismissed earlier. See *Green v. Fund Asset Mgmt., L.P., et al.*, 19 F. Supp. 2d 227 (D.N.J. 1998). The Court declined to accept jurisdiction of plaintiffs' state law claims for breach of fiduciary duty and deceit; they were dismissed without prejudice to refile in state court. 2Section 36(b) to recovery of excessive advisory fees (i.e., it declined to follow *Gartenberg*), it found plaintiffs' allegations with respect to this claim inadequate. Even if the advisers calculated their fees in a manner that represented an actual conflict with the interests of the shareholders and the Funds, the court found that this is not per se a breach of fiduciary duty. The court added that approval of the advisory agreement by directors "mitigates

strongly against the contention that the advisors [sic] have breached their fiduciary duty to the [F]unds or their shareholders.” A copy of the court’s opinion is attached to this memorandum. Marguerite C. Bateman Associate Counsel Attachment Note: Not all recipients receive the attachment. To obtain a copy of the attachment to which this memo refers, please call the ICI Library at (202) 326-8304 and request the attachment for memo 13657. ICI Members may retrieve this memo and its attachment from ICINet (<http://members.ici.org>). Attachment (in .pdf format)

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