

**MEMO# 11139**

July 29, 1999

## **COURT DISMISSES SECOND AMENDED COMPLAINT IN CASE CHALLENGING DIRECTOR INDEPENDENCE**

1 Verkouteren v. Blackrock Financial Management, Inc., 98 Civ. 4673 (S.D.N.Y. July 16, 1999). 2 Verkouteren v. Blackrock Financial Management, Inc., 98 Civ. 4673 (S.D.N.Y. Feb. 4, 1999). See also Memorandum to Board of Governors No. 6-99, Closed-End Investment Company Members No. 10-99, Director Services Committee No. 7-99, and SEC Rules Members No. 18-99, dated February 12, 1999. [11139] July 29, 1999 TO: BOARD OF GOVERNORS No. 48-99 CLOSED-END INVESTMENT COMPANY MEMBERS No. 28-99 DIRECTOR SERVICES COMMITTEE No. 21-99 SEC RULES MEMBERS No. 47-99 RE: COURT DISMISSES SECOND AMENDED COMPLAINT IN CASE CHALLENGING DIRECTOR INDEPENDENCE

The United States District Court for the Southern District of New York has dismissed a shareholder's second amended complaint against a registered investment adviser alleging violations of Sections 10(a) and 15(c) of the Investment Company Act of 1940 (the "Act") and breach of fiduciary duty under Section 36(b) of the Act.<sup>1</sup> Essentially, the plaintiff claimed that 40% of the directors of the funds advised by the adviser were not independent as required by Section 10(a) of the Act because, through the payment of substantial fees for service on multiple fund boards, they had become "interested persons" within the meaning of the Act. In February, the Court dismissed the shareholder's first amended complaint for failure to overcome the statutory presumption that the independent directors are not "controlled persons" as defined in Section 2(a)(9) of the Act.<sup>2</sup> The court granted the shareholder an opportunity to amend his complaint to provide specific factual allegations sufficient to rebut this presumption in concrete terms. In granting the adviser's motion to dismiss the second amended complaint, the court found that the plaintiff failed to provide circumstantial evidence of control that "relates specifically to allegations of domination by the defendant" that cannot be explained by any other factor. The plaintiff's allegations included the following: (1) directors receive substantial compensation; (2) service on twenty-one separate fund boards prevents directors from adequately performing their "watchdog" function; (3) directors failed in their duty to "request and evaluate" the advisory agreement because they met only five times in 1997; (4) the board has no separate nominating committee composed exclusively of independent directors; (5) the trust's by-laws make it difficult for funds to request a special meeting; (6) the adviser has de facto power to remove directors; (7) directors approved a 50% increase in the advisory fee, notwithstanding a decline in the trust's net asset value and a stagnated stock price. The court held that these allegations, among others, do not provide proof of director domination because they easily could 3 As in its earlier decision, the court again dismissed the

plaintiff's Section 36(b) claim because the second amended complaint failed to support a finding that the independent directors were "interested" and that the advisory fee was excessive. Also, because the plaintiff did not establish that the directors were "interested", the court did not need to address his claims under Sections 36(a), 10(a) and 15(c) of the Act. The court did note for the record, however, that plaintiff's "failure to make a formal demand on the board ought not to bar his derivative claims given that they allege director interest." result from other causes such as ineffective performance by the directors of their duties or failure of the shareholders to adequately supervise the directors.<sup>3</sup> A copy of the order is attached. Doretha VanSlyke Zornada Assistant Counsel Attachment Note: Not all recipients receive the attachment. To obtain a copy of the attachment referred to in this Memo, please call the ICI Library at (202) 326-8304, and ask for attachment number 11139. ICI Members may retrieve this Memo and its attachment from ICINet (<http://members.ici.org>).

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