

MEMO# 11940

June 9, 2000

COURT DISMISSES CHALLENGE TO FUND DIRECTOR INDEPENDENCE BUT SUSTAINS SECTION 36(B) CLAIM

1 Krantz v. Fidelity Management & Research Co., et al., Civil Action No. 98-11988-PBS (D. MA. May 31, 2000). 2 See Verkouteren v. Blackrock Fin. Management, Inc., 37 F. Supp. 2d 256, 259 (S.D.N.Y. 1999), aff'd, 28 F.3d 204 (2d Cir. 2000). [11940] June 9, 2000 TO: BOARD OF GOVERNORS No. 32-00 CLOSED-END INVESTMENT COMPANY MEMBERS No. 11-00 INVESTMENT COMPANY DIRECTORS No. 10-00 SEC RULES MEMBERS No. 37-00 SMALL FUNDS MEMBERS No. 11-00 RE: COURT DISMISSES CHALLENGE TO FUND DIRECTOR INDEPENDENCE BUT SUSTAINS SECTION 36(b) CLAIM

The United States District Court for the District of Massachusetts recently issued an order in which it dismissed a shareholder's claim that the directors of certain funds in a complex are under the control of the investment adviser in violation of Sections 10(a), 15(c) and 36(a) of the Investment Company Act of 1940. The court allowed the plaintiff's claim of excessive advisory fees under Section 36(b) of the Investment Company Act to stand.¹ The court determined that, although the same nine independent directors serve on the twelve-person boards of all of the investment companies in a large complex and receive substantial annual salaries, the plaintiff failed to allege sufficient facts to rebut the statutory presumption of non-control and render the directors "interested" within the meaning of the Investment Company Act. The court observed that neither the Act nor the SEC proscribes the use of interlocking boards within mutual fund complexes. Citing a recent case,² the court said that "while well-compensated membership on multiple boards within a fund complex is one factor in the control crucible," without other indicia of control, most courts have concluded that it is not sufficient to rebut the statutory presumption against control. The court permitted the claim of excessive fees under Section 36(b) to stand. Based on its analysis of the factors in the Gartenberg case for determining whether fees are "so disproportionately large that [they] bear no reasonable relationship to the services rendered and could not have been the product of arm's length bargaining," the court found that there were sufficient allegations of facts in the complaint to support four of the six factors. Viewing these facts in a light most favorable to the plaintiff and finding that the defendant likely was the only source of documentation to support certain of the plaintiff's allegations, the court denied the defendant's motion to dismiss this claim. A copy of the Memorandum and Order in this action is attached. Marguerite C. Bateman Associate 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 11940. ICI Members may retrieve this Memo and its attachment from ICINet (<http://members.ici.org>).

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