The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 9189

August 22, 1997

DISTRICT COURT DENIES MOTION FOR RECONSIDERATION OF HOLDING IN STROUGO CASE

1 Strougo v. Padegs, 964 F. Supp. 783 (S.D.N.Y. 1997). See Memorandum to SEC Rules Members No. 37-97 and Closed- End Investment Company Members No. 15-97, dated May 16, 1997. 2 See Memorandum to Board of Governors No. 34-97, Closed-End Investment Company Committee No. 21-97 and SEC Rules Committee No. 54-97, dated May 27, 1997. [9189] August 22, 1997 TO: BOARD OF GOVERNORS No. 50-97 CLOSED-END INVESTMENT COMPANY COMMITTEE No. 30-97 SEC RULES COMMITTEE No. 81-97 RE: DISTRICT COURT DENIES MOTION FOR RECONSIDERATION OF HOLDING IN STROUGO CASE

_____ In May of this year, the United States District Court for the Southern District of New York ruled that a shareholder bringing a derivative action based on an allegedly "coercive" closed-end fund rights offering was not required to make prior demand on the funds directors because three of the funds four independent directors "received substantial compensation" in connection with their service on multiple fund boards within the same complex.1 As we previously reported, the Institute, as amicus curiae, submitted a memorandum to the court urging it to reconsider its opinion or, in the alternative, to certify the opinion for interlocutory appeal to the Court of Appeals for the Second Circuit.2 In an opinion dated August 15, 1997 (and received by the Institute August 20), the court granted the Institutes motion to participate amicus curiae but denied motions for reconsideration or certification of the case. A copy of the courts opinion is attached. In denying reconsideration, the court opined that it had "overlooked neither controlling decisions nor dispositive factual matters put before it on the underlying motions to dismiss." For example, the court disagreed with the contention that it overlooked the ‘tension between the statutory and regulatory definitions of an "interested person" and the courts conclusion that demand on the directors was excused where all but one board member serves on multiple fund boards within a single complex and earns "significant compensation" from the fund complex. According to the court, this ‘tension is a result of the Supreme Courts determination that state law, and not federal law, governs demand futility in Investment Company Act cases. In addition, the opinion indicates that the court did not overlook the dismissal of a complaint with similar allegations in Kamen v. Kemper Fin. Servs., Inc., 939 F.2d 458 (7th Cir. 1991). The opinion notes, among other things, that Kamen is not controlling authority and that Kamen is distinguishable on its facts because, in that case, only seven of the ten "purportedly independent" directors served on multiple boards. Under Maryland law, which requires a minimum of two directors to form a committee, the three remaining "indisputably independent" directors could form a litigation committee to consider a shareholder demand to institute a lawsuit. In contrast, in the Strougo case, only one director does not serve on multiple boards. Finally, the court was

not persuaded by arguments that its ruling should be certified for immediate appeal because it might affect a large number of cases and could cause a dramatic and expensive restructuring of the investment company industry. The opinion states that the courts ruling would not eliminate multiple directorships but rather "would require only that a sufficient number of directors without such multiple directorships . . . serve on each board so that a litigation committee could be convened to consider proposed litigation." It points out that the courts decision applies only to funds incorporated in Maryland and that, under Delaware law, interlocking directorships are not a ground for excusing demand. The Institute is considering various measures to address this issue. Paul Schott Stevens Senior Vice President General Counsel Attachment (in .pdf format)
