The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 11670

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RECENT COURT OPINIONS CONSIDER DIRECTOR SERVICE ON MULTIPLE FUND BOARDS

1 Roumell v. Templeton Asset Management, et al. and Wetta v. Templeton Asset Management, et al., 98-6059-Civ-Hurley (S.D. Fl. Dec. 9, 1999). 2 Marquit v. Dobson, et al., 98 Civ. 9089 (JSM) (S.D.N.Y. Dec. 29, 1999). [11670] February 23, 2000 TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 7-00 DIRECTOR SERVICES COMMITTEE No. 6-00 SEC RULES COMMITTEE No. 24-00 RE: RECENT COURT OPINIONS CONSIDER DIRECTOR SERVICE ON MULTIPLE FUND BOARDS

_____ Two recent court opinions have considered whether the receipt of compensation for service on multiple fund boards alone deems a director "interested" under the Investment Company Act of 1940. In the first order, the United States District Court for the Southern District of Florida granted in part and denied in part motions to dismiss complaints alleging breach of fiduciary duty under Maryland law in related cases brought by two investors in the same closed-end fund.1 In the second case, the United States District Court for the Southern District of New York granted the motion to dismiss the plaintiff's class action complaints against three closed-end funds, two of which were managed by the same investment adviser, alleging breach of fiduciary duty under the Investment Company Act and Maryland law. 2 In the first case, in addition to the allegations in the complaints that the defendants had breached various provisions of the Investment Company Act and the Investment Advisers Act of 1940, one plaintiff alleged that the independent directors had breached their fiduciary duty, as defined by Maryland law, to the fund and the plaintiffs. Specifically, the plaintiff alleged that the deviation from the fund's investment policy and failure to hold a shareholder vote in a timely manner constituted a breach of fiduciary duty. Defendants argued that the claim should be dismissed, among other reasons, because the plaintiff failed to make a demand on the board to pursue litigation or to allege with particularity that demand was futile. The court, citing Strougo v. Scudder, Stevens & Clark, Inc., 964 F. Supp. 783 (S.D.N.Y. 1997), stated that Maryland law governs whether demand is required and the conditions that will excuse demand. Noting that demand is futile when directors are interested persons under the Investment Company Act (because Maryland law incorporates the definition of "interested person" in the Investment Company Act), the court found that the plaintiff had alleged sufficient facts in his complaint to demonstrate that the demand was futile. The facts alleged in the complaint included that the director defendants, by virtue of their multiple directorships and the substantial payments they received for this service, were dominated or otherwise controlled or beholden to the adviser. The motion to dismiss on this ground was denied. In the second case, brought in the jurisdiction of the original Strougo case, the court granted the motion to dismiss on the ground that the

claims asserted were derivative and, as required in derivative actions, the plaintiff failed to first seek action from the board or show that such a request would be futile. The court distinguished the Strougo case, finding that, on the face of the complaints, there were no facts that would demonstrate that such a demand would be futile. The court noted that "[w]hile Judge Sweet found in Strougo that allegations that the directors received substantial remuneration from their service on the boards of other funds managed by the same adviser would constitute interest, there are no such allegations here." The court added that in the instant case,"[i]t is doubtful that the mere fact that a director serves on the board of two funds would be sufficient to compel the conclusion that he was not disinterested." Marguerite C. Bateman Associate Counsel Attachments

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