

MEMO# 10725

February 12, 1999

COURT DISMISSES COMPLAINT IN CASE CHALLENGING DIRECTOR INDEPENDENCE

1 Verkouteren v. Blackrock Financial Management, Inc., 98 Civ. 4673 (S.D.N.Y. 1999). 2 See Olesh v. Dreyfus Corporation (E.D.N.Y. 1995), 1995 WL 500491, and First Australia Fund (pub. avail. Sept. 8, 1987). [10725] February 12, 1999 TO: BOARD OF GOVERNORS No. 6-99 CLOSED-END INVESTMENT COMPANY MEMBERS No. 10-99 DIRECTOR SERVICES COMMITTEE No. 7-99 SEC RULES MEMBERS No. 18-99 RE: COURT DISMISSES COMPLAINT IN CASE CHALLENGING DIRECTOR INDEPENDENCE

The United States District Court for the Southern District of New York has dismissed a shareholder's 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).¹ 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. Consequently, the plaintiff sought to void the advisory agreements between the funds and the adviser, and recover all fees paid under these agreements, on the grounds that they were not approved by a majority of the independent directors in violation of Section 15(c). The plaintiff also alleged that the investment adviser breached its fiduciary duty under Section 36(b) to negotiate at arm's-length with the funds in the complex by virtue of its receipt of fees from invalid advisory agreements. In granting the adviser's motion to dismiss, the court found that the plaintiff failed to overcome the statutory presumption that independent directors are not "controlled persons" as defined in Section 2(a)(9) of the Act. The court expressed the view that the single most important factor in determining whether an independent director is "controlled" is proof of "actual domination and operation."² The court found that the factual allegations in the complaint and the arguments put forth at oral argument did not explicitly address this issue, and were otherwise insufficient to rebut the presumption that a natural person is not a "controlled person" under the Act. In evaluating the claim of breach of fiduciary duty, the court found that the plaintiff's two arguments were rendered moot by the court's earlier finding that the independent directors were not.³ In so doing, the court noted that it did not have to address the question of whether the plaintiff, as a shareholder in only one of the twenty-one funds in the complex, had standing to assert a claim to collect fees paid to the adviser by all of the funds. "interested." The court also dismissed the plaintiff's claim for recovery of fees for failure to state a cause of action under the Act.³ The court gave the plaintiff leave to amend his complaint within thirty days. A copy of the order is attached. Doretha M. VanSlyke Assistant Counsel Attachment Note: Not all recipients of this memo will receive an attachment. If you wish to obtain a copy of the attachment referred to in this memo, please call the Institute's Library Services Division at

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