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# Disinterested Directors, Independent Directors and the Investment Company Act of 1940

JOEL H. GOLDBERG\*

## INTRODUCTION

To help protect registered investment companies against conflicts of interest on the part of their management, the Investment Company Act of 1940<sup>1</sup> generally prohibits more than sixty percent of such a company's directors from being associated with the company's management.<sup>2</sup> However, it is clear that the original framers of the Investment Company Act did not contemplate that the oversight of directors who are not associated with an investment company's management would be sufficient by itself to protect such companies against conflicts of interest. Thus, the Act prohibits a wide variety of transactions on the part of investment companies, at least without Commission permission, even if the transactions are approved by directors not associated with the company's management.

The extent of dissociation from management required on the part of a minority of investment companies' directors was increased somewhat in 1970 when the Investment Company Act was amended to require that such directors not be "interested persons" of the company,<sup>3</sup> instead of requiring merely that they not be "affiliated

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1. Investment Company Act, ch. 686, title I, 54 Stat. 789 (1940) (current version at 15 U.S.C. §§ 80a-1 *et seq.* (1970), *as amended in* 15 U.S.C. §§ 80a-1 *et seq.* (Supp. V 1975)).

2. Section 80a-10 of the Act as amended in 1970 provides: "(a) No registered investment company shall have a board of directors more than 60 per centum of which are interested persons of such registered company." 15 U.S.C. § 80a-10 (1970).

3. "Interested person" is defined in § 2(a)(19) of the Investment Company Act:

- (A) when used with respect to an investment company—
  - (i) any affiliated person of such company,
  - (ii) any member of the immediate family of any natural person who is an affiliated person of such company,
  - (iii) any interested person of any investment adviser of or principal underwriter for such company,
  - (iv) any person or partner or employee of any person who at any time since the

persons”<sup>4</sup> of the company, as had previously been the case.<sup>5</sup> In addition, the role of disinterested directors in major decisions of

beginning of the last two fiscal years of such company has acted as legal counsel for such company,

(v) any broker or dealer registered under the Securities Exchange Act of 1934 or any affiliated person of such a broker or dealer, and

(vi) any natural person whom the Commission by order shall have determined to be an interested person by reason of having had, at any time since the beginning of the last two fiscal years of such company, a material business or professional relationship with such company or with the principal executive officer of such company or with any other investment company having the same investment adviser or principal underwriter or with the principal executive officer of such other investment company:

*Provided*, That no person shall be deemed to be an interested person of an investment company solely by reason of (aa) his being a member of its board of directors or advisory board or an owner of its securities, or (bb) his membership in the immediate family of any person specified in clause (aa) of this proviso; and

(B) when used with respect to an investment adviser of or principal underwriter for any investment company—

(i) any affiliated person of such investment adviser or principal underwriter,

(ii) any member of the immediate family of any natural person who is an affiliated person of such investment adviser or principal underwriter,

(iii) any person who knowingly has any direct or indirect beneficial interest in, or who is designated as trustee, executor, or guardian of any legal interest in, any security issued either by such investment adviser or principal underwriter or by a controlling person of such investment adviser or principal underwriter,

(iv) any person or partner or employee of any person who at any time since the beginning of the last two fiscal years of such investment company has acted as legal counsel for such investment adviser or principal underwriter,

(v) any broker or dealer registered under the Securities Exchange Act of 1934 or any affiliated person of such a broker or dealer, and

(vi) any natural person whom the Commission by order shall have determined to be an interested person by reason of having had at any time since the beginning of the last two fiscal years of such investment company a material business or professional relationship with such investment adviser or principal underwriter or with the principal executive officer or any controlling person of such investment adviser or principal underwriter . . . .

15 U.S.C. § 80a-2(a)(19) (1970).

4. “Affiliated person” is defined in § 2(a)(3) of the Investment Company Act:

(A) any person directly or indirectly owning, controlling, or holding with power to vote, 5 per centum or more of the outstanding voting securities of such other person;

(B) any person 5 per centum or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person; (C) any person directly or indirectly controlling, controlled by, or under common control with, such other person; (D) any officer, director, partner, copartner, or employee of such other person; (E) if such other person is an investment company, any investment adviser thereof or any member of an advisory board thereof; and (F) if such other person is an unincorporated investment company not having a board of directors, the depositor thereof.

15 U.S.C. § 80a-2(a)(3) (1970).

5. Section 80a-10 of the Investment Company Act of 1940 provided in part:

(a)[N]o registered investment company shall have a board of directors more than 60 per centum of the members of which are persons who are investment advisers of, affiliated persons of an investment adviser of, or officers or employees of, such

investment companies was modified and, in some ways, expanded when the Investment Company Act was amended in 1970 and again in 1975.<sup>6</sup> Nonetheless, even after these amendments, the Investment Company Act continued to impose a thoroughgoing system of regulation on investment companies.

The imposition of regulatory strictures as a substitute for, or at least a supplement to, the judgment of disinterested investment company directors is undoubtedly justified by the fact that many such directors do not have either the expertise and sophistication or the access to expert advice necessary to protect an investment company adequately against conflicts of interest on the part of its management. However, the 1977 opinion of the Court of Appeals for the Second Circuit in *Tannenbaum v. Zeller*<sup>7</sup> suggests that a distinction can be made between those investment company directors who are merely "disinterested" within the meaning of the Investment Company Act, and those who are not only disinterested but also genuinely *independent*: that is, capable of exercising informed judgment with regard to an investment company's affairs without relying upon the advice of the company's management. It would be difficult, and it might even be impossible, to formulate and apply standards of general applicability for defining genuinely independent investment company directors, and it is not the purpose of this article to propose such standards. However, this article is intended to suggest that, if a means could be found to determine which investment company directors were in fact independent, it might be feasible to substitute the judgment of such directors, at least in part, for some of the regulatory strictures now imposed upon investment companies. The benefits which such a substitution could produce for the investment company industry, public shareholders, and the federal government would be so significant that an attempt should be made to formulate a means of determining independence on the part of investment company directors, notwithstanding the difficulty and uncertain success of such an undertaking.

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registered company.

Investment Company Act, ch. 686, title I, § 10, 54 Stat. 789 (1940) (current version at 15 U.S.C. § 80a-10 (1970)).

6. Investment Company Amendments Act of 1970, Pub. L. No. 91-547, 84 Stat. 1413 (1970); and Securities Acts Amendments of 1975, Pub. L. No. 94-29, 89 Stat. 163 (1975).

7. 552 F.2d 402 (2d Cir.), *cert. denied*, 98 S. Ct. 421 (1977).

REQUIREMENTS OF THE INVESTMENT COMPANY ACT CONCERNING  
DISINTERESTED DIRECTORS

*Before the 1970 Amendments*

Until the Investment Company Act was amended in 1970,<sup>8</sup> it contained no reference to "interested persons."<sup>9</sup> However, using the more limited concept of "affiliated person,"<sup>10</sup> section 10(a) of the original Act, like section 10(a) of the Act as now amended, provided in effect that, in general, no more than sixty percent of a registered investment company's board of directors could consist of persons associated with the company's investment adviser.<sup>11</sup> The fact that this provision permitted a majority of an investment company's directors to be affiliated with the investment adviser suggests that the framers of the Act contemplated only a limited role for the unaffiliated directors in safeguarding the interests of the company's public shareholders.

This conclusion is reinforced by the presence of numerous other provisions of the Act which limit the discretion of an investment company's management to engage in various types of transactions or activities, regardless of whether those transactions or activities are approved by the company's unaffiliated directors. For example,

8. Investment Company Amendments Act of 1970, Pub. L. No. 91-547, 84 Stat. 1413 (1970).

9. For the statutory definition of "interested person" under the 1970 amendments, see note 3 *supra*.

10. For the statutory definition of "affiliated person" under the Act, see note 4 *supra*.

11. For the original text of § 80a-10a, see note 5 *supra*. However, under § 10(b) of the Act, 15 U.S.C. § 80a-10(b) (1940), if any of the investment company's directors, officers, or employees served as, or was affiliated with, a principal underwriter or regular broker for the company, a majority of the board of directors had to be unaffiliated with that underwriter or broker. A similar provision is made in the present § 10(b), 15 U.S.C. § 80a-10(b) (1970), using the "interested person" concept. Additionally, in the original Act, as well as in the Act as amended, an exception was made in § 10(d) for a certain type of open-end, no-load company the investment adviser of which is engaged principally in the business of managing individual accounts rather than investment companies. If the company meets this and other specified requirements, all except one of its directors may be interested persons of the company. This exception apparently had its origin when, at the congressional hearings preceding passage of the Act in 1940, a partner in the investment counsel firm of Scudder, Stevens & Clark indicated that that firm had formed investment companies in order to pool the assets of clients whose accounts would otherwise be too small to manage economically. See *Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 76th Cong., 3d Sess. 700-01 (1940) (testimony of James N. White) [hereinafter cited as *1940 Senate Hearings*]. The Scudder, Stevens & Clark official argued that it would be unnecessary and unfair to force these investment companies to increase the representation of unaffiliated directors on their boards to more than the one such director which they already had, *id.* at 703, and this argument seems to have persuaded the drafters of the Act to provide the exception contained in § 10(d). See *Hearings on H.R. 10065 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce*, 76th Cong., 3d Sess. 111 (1940) (testimony of David Schenker) [hereinafter cited as *1940 House Hearings*].

sections 17(a) and 17(b) of the Act, taken together, prohibit, among other things, purchases or sales of property from or to a registered investment company by an affiliated person of the company unless an order permitting the transaction has been issued by the Securities and Exchange Commission.<sup>12</sup> A somewhat similar prohibition is contained in section 17(d) of the Act with respect to joint transactions between registered investment companies and their affiliates.<sup>13</sup>

Furthermore, although the prohibitions of section 17 are aimed mainly at alleviating the danger of a conflict of interest where a person associated with the company's management or some other affiliated person of the company deals with it, activities involving conflicts of interest are not the only ones prohibited or limited by the Investment Company Act. For example, section 18(a) delimits the circumstances under which a registered closed-end investment company may issue senior securities,<sup>14</sup> and section 18(f) generally prohibits registered open-end investment companies from issuing senior securities at all, although such companies are permitted to borrow from banks subject to certain conditions.<sup>15</sup> Other provisions of the Investment Company Act that provide regulatory protection to investors with regard to matters which do not necessarily involve a conflict of interest on the part of persons affiliated with the investment company are sections 22(a)-(d), concerning the pricing of open-end investment company shares,<sup>16</sup> section 22(e), concerning

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12. 15 U.S.C. §§ 80a-17(a), 17(b)(1970).

13. *Id.* § 80a-17(d). Unlike § 17(a), § 17(d) is not self-effecting; it only prohibits transactions in contravention of such rules and regulations as the Commission may adopt pursuant to that section. Pursuant to the authority provided in § 17(d), the Commission has adopted rule 17d-1, 17 C.F.R. § 270.17d-1 (1977), which generally prohibits transactions within the purview of that section in the absence of a Commission order permitting the transaction. Other differences between § 17(a) and § 17(d) are discussed in Rosenblat & Lybecker, *Some Thoughts on the Federal Securities Laws Regulating External Investment Management Arrangements and the ALI Federal Securities Code Project*, 124 U. PA. L. REV. 587, 598-99, 643 (1976).

14. 15 U.S.C. § 80a-18(a)(1970).

15. *Id.* § 80a-18(f). It might be noted that, although most of the prohibitions of the Investment Company Act (such as those contained in § 18) do not include a specific provision for exemptive orders of the Commission like that set forth in § 17(b), it is not really accurate to speak of an outright prohibition being imposed by the Investment Company Act. This is because § 6(c) of the Act, 15 U.S.C. § 80a-6(c) (1970) empowers the Commission to grant exemptions from any provision of the Act "if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of" the Act.

16. 15 U.S.C. §§ 80a-22(a)-(d). Sections 22(a) and (c), taken together, in effect give the National Association of Securities Dealers, Inc. (NASD) and the Commission authority to make rules to prevent mutual fund shares from being priced in a manner which will dilute the value of already outstanding shares. Section 22(b), as amended in 1970, in effect gives the NASD and the Commission rulemaking authority to prevent excessive sales loads. Sec-

suspension of the right of redemption of open-end shares,<sup>17</sup> section 22(f), regarding restrictions on transferability or negotiability of such shares,<sup>18</sup> and section 22(g), concerning the sale of open-end shares for other than cash or securities.<sup>19</sup> Provisions with respect to the distribution and repurchase of closed-end investment company shares are set forth in section 23 of the Act.<sup>20</sup>

The existence of these and other provisions indicate that, from the outset, the framers of the Investment Company Act intended to rely at least as much upon regulatory strictures as upon the oversight of unaffiliated directors to ensure that investment company shareholders would be protected not only with regard to dealings by the company with affiliated persons who might have a conflict of interest, but also with regard to other activities on the part of investment companies which might endanger the interests of investors. Further evidence of the limited role envisioned for unaffiliated directors under the Investment Company Act can be found in the Act's legislative history. The original version of the legislation would have required, in section 10(a), that a majority of an investment company's directors be unaffiliated with the company's investment adviser.<sup>21</sup> In explaining why this provision was modified in later versions of the legislation to require only that forty percent of the directors be unaffiliated with the investment adviser, David Schenker, one of the Commission's primary spokesmen at the legislative hearings leading to passage of the Act,<sup>22</sup> stated the following at the hearings in the House of Representatives:

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tion 22(d) generally prohibits the sale of mutual fund shares to the public except at a current offering price described in the prospectus, and therefore in effect prohibits mutual fund dealers from discounting the sales load. The purpose of this section has been the subject of some controversy. On the one hand, it has been suggested that § 22(d) was intended to eliminate a price-competitive secondary market in mutual fund shares which was, under this theory, disrupting mutual fund distribution systems and resulting in discrimination among investors. See, e.g., Greene, *The Uniform Offering Price of Mutual Fund Shares Under the Investment Company Act of 1940*, 37 U. DET. L.J. 369, 370-73 (1960). Other commentators, however, have suggested that the purpose of § 22(d) was to prevent mutual fund insiders from purchasing shares at less than net asset value and thereby diluting the value of other shareholders' investments. See Heffernan & Jordan, *Section 22(d) of the Investment Company Act of 1940—Its Original Purpose and Present Function*, 1973 DUKE L.J. 975.

17. 15 U.S.C. § 80a-22(e) (1970).

18. *Id.* § 80a-22(f).

19. *Id.* § 80a-22(g).

20. *Id.* § 80a-23.

21. 1940 *Senate Hearings*, *supra* note 11, at 8.

22. Mr. Schenker was the Commission's counsel for the Investment Trust Study, SEC, *Report on Investment Trusts and Investment Companies*, H.R. Doc. No. 279, 76th Cong., 1st Sess. (1939). That study largely formed the basis of the Act.

[T]he argument was made that it is difficult for a person or firm to undertake the management of an investment company, give advice, when the majority of the board may repudiate that advice. It was urged that if a person is buying management of a particular person and if the majority of the board can repudiate his advice, then in effect, you are depriving the stockholders of that person's advice.

Now, that made sense to us. If the stockholders want A's management, than [sic] A should have the right to impose his investment advice on that company. However, we felt that there should be some check on the management and that is why the provision for 40 percent of independents was inserted.<sup>23</sup>

#### *After the 1970 Amendments*

In 1966, the SEC issued its *Report on the Public Policy Implications of Investment Company Growth* (PPI).<sup>24</sup> In that report, the Commission expressed concern that the fees paid by open-end investment companies to their external investment advisers might be higher than necessary,<sup>25</sup> and it ascribed excessive mutual fund advisory fees in part to "the difficulty of effective action by unaffiliated directors."<sup>26</sup>

In elaborating upon the role of unaffiliated directors, the Commission suggested in PPI that, although such directors often performed a valuable service for mutual fund shareholders, the usefulness of unaffiliated directors was limited by the several facts: they usually served as mutual fund directors only part-time, they worked without independent staff and usually without independent counsel, and they obtained most of their information about fund operations from employees of the company's investment adviser.<sup>27</sup> For this and other reasons, the Commission concluded that "in general the unaffiliated directors have not been in a position to secure changes in the level of advisory fee rates in the mutual fund industry."<sup>28</sup>

As one means of increasing the effectiveness of unaffiliated directors in representing investment company shareholders' interests, the Commission recommended that the Investment Company Act be amended to require a greater separation between the economic

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23. 1940 House Hearings, *supra* note 11, at 109-10.

24. *Report of the Securities and Exchange Commission on the Public Policy Implications of Investment Company Growth*, H.R. REP. NO. 2337, 89th Cong., 2d Sess. (1966) [hereinafter cited as PPI].

25. *Id.* at 11.

26. *Id.* at 12.

27. *Id.* at 130-31.

28. *Id.* at 131.



interests of such directors and the interests of the company's management than was produced by the Act's reliance upon the "affiliated person" concept.<sup>29</sup> Thus, the Commission recommended that those directors required by the Act to be unassociated with the investment company's management be not only unaffiliated, but also "disinterested."<sup>30</sup> The definition of "interested person" which the Commission recommended be added to the Act was similar to that now contained in section 2(a)(19),<sup>31</sup> inasmuch as the Commission's definition would have included, in addition to affiliated persons, the immediate families of affiliated persons and individuals who had had a material business or professional relationship with an affiliated person of the company within the past three years.<sup>32</sup>

Congress adopted the Commission's suggestion that a definition of "interested person" be added to the Investment Company Act in order to increase the separation between the interests of an investment company's unaffiliated directors and those of its management. In addition, as part of the 1970 amendments to the Act, Congress adopted certain other recommendations of the Commission designed to increase, to some extent, the effectiveness of disinterested directors' oversight with regard to investment companies' affairs. Specifically, the Commission recommended,<sup>33</sup> and Congress enacted, requirements that the vote of disinterested directors with respect to investment advisory and principal underwriting contracts, as well as with respect to the selection of independent auditors, be cast in person.<sup>34</sup> Section 15(c) of the Act was also amended in 1970 to provide for a duty on the part of a registered investment company's directors to request and evaluate, and a duty on the part of the company's investment adviser to furnish, information neces-

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29. *Id.* at 334.

30. *Id.*

31. 15 U.S.C. § 80a-2(a)(19) (1970).

32. PPI, *supra* note 24, at 334.

33. *Id.*

34. 15 U.S.C. §§ 80a-15(c), 80a-31(a) (1970). Section 15(c) of the Investment Company Act now requires that investment advisory and underwriting contracts be approved by a majority of the disinterested directors, and § 32(a) imposes a similar requirement with respect to the selection of independent auditors. The Act had previously required that investment advisers and principal underwriters be approved by either a shareholder vote or by the directors who were unaffiliated with either the investment company or its investment adviser, and that independent auditors be approved by the directors who were unaffiliated with the investment adviser. 54 Stat. 813, 838. However, there had been no requirement that the unaffiliated directors' votes concerning these matters be cast in person. The Commission said in PPI that absentee votes concerning these matters had not been uncommon, and it took the position that informed voting on the part of the directors could best be assured by requiring physical attendance when the votes were cast. PPI, *supra* note 24, at 335.

sary to evaluate the terms of an advisory contract.<sup>35</sup>

However, although these changes in the Investment Company Act reflected a determination on the part of Congress that unaffiliated investment company directors should be more dissociated from the company's management and should more actively participate in major decisions of the company than had previously been the case, Congress indicated no willingness to reduce the extent of regulatory checks upon directors' judgment already provided for in the Act. To the contrary, an examination of the history of another provision added to the Investment Company Act in 1970, section 36(b),<sup>36</sup> suggests that Congress and the Commission were as skeptical of the ability of unaffiliated (or now, disinterested) directors to protect public shareholders against conflicts of interest on the part of an investment company's management as the original framers of the Act had been in 1940.

Section 36(b) of the Investment Company Act specifies that there is a fiduciary duty on the part of a registered investment company's investment adviser with respect to the receipt of compensation from the company.<sup>37</sup> Prior to the 1970 amendments, section 36 of the Act had authorized the Commission to seek injunctive relief against an investment company's investment adviser and other persons associated with the company's management only in cases involving "gross misconduct or gross abuse of trust."<sup>38</sup> In PPI, the Commission expressed the view that this section did not provide a practical means for preventing excessive advisory fees,<sup>39</sup> and suggested that the Act be amended to provide that the compensation received by investment advisers from investment companies must be "reasonable."<sup>40</sup> As part of that recommendation, the Commission took the position that the application of the reasonableness standard should not be affected by the fact that shareholders or directors might have approved the advisory contract or other compensation arrangement.<sup>41</sup> The Commission explained that this portion of its recommendation was

designed to make inapplicable to investment company management compensation the judicial decisions which have held that such action by shareholders or disinterested directors changes the

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35. 15 U.S.C. § 80a-15(c) (1970).

36. *Id.* § 80a-35(b).

37. *Id.*

38. Investment Company Act, ch. 686, title I, § 36, 54 Stat. 841 (1940).

39. PPI, *supra* note 24, at 143.

40. *Id.* at 143-44.

41. *Id.* at 144.

standard from fairness to "waste." Although these decisions were not reached in connection with a statutory standard of reasonableness such as proposed by the Commission, the ineffectiveness of shareholder and directorial approval as a restraint on management compensation in the investment company industry makes it important to eliminate any doubt on this question. To permit such action to impede the operation and enforcement of a Federal standard of reasonableness, as it has in the case of standards imposed by State law, would be wholly inconsistent with the reasons for and the purpose of such a statutory standard.<sup>42</sup>

Congress did not adopt either the Commission's recommendation that the Act explicitly provide that advisory fees must be reasonable, or its recommendation that approval by shareholders or directors not be a factor in determining whether the standard of reasonableness had been met. The version of section 36(b) which Congress did enact specified that an investment adviser has a fiduciary duty with respect to the receipt of compensation. That pronouncement, however, seems to have the same effect as a reasonableness standard since it appears that a breach of fiduciary duty could occur when the fiduciary permits the investment company to pay an unreasonable charge.<sup>43</sup> The fiduciary duty standard was substituted for the reasonableness standard only because the investment company industry had objected that the reasonableness standard would focus litigation on mutual fund directors rather than advisers.<sup>44</sup>

Furthermore, while Congress did not adopt the SEC's suggestion that the Act be made to provide that the application of a standard of reasonableness with respect to advisory fees would not be affected by shareholders' or directors' approval of the fee, Congress did provide in section 36(b) that, in an action under that section, such approval "shall be given such consideration by the court as is deemed appropriate under all the circumstances."<sup>45</sup> Although this

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42. *Id.* at 145-46.

43. See *Memorandum of the Securities and Exchange Commission in Response to Query by Chairman Moss Regarding the Difference Between the "Reasonableness" Standard in S. 34 and the "Breach of Fiduciary Duty" Standard of S. 2224 and H.R. 11995 With Respect to Management Fees, Hearings on H.R. 11995, S. 2224, H.R. 13754, and H.R. 14737 Before the Subcomm. on Commerce and Finance of the Comm. on Interstate and Foreign Commerce, 91st Cong., 1st Sess. 187, 189 (1969)* [hereinafter cited as *Memorandum of Securities and Exchange Commission*]. See also 115 CONG. REC. 13696 (1969) (remarks of Senator Bennett), and 115 CONG. REC. 13699 (1969) (remarks of Senator Percy). It might be noted that § 36(b) specifies that investment company shareholders, as well as the Commission, can bring actions for breach of fiduciary duty under that section.

44. See *Memorandum of the Securities and Exchange Commission, supra* note 43, at 188-89.

45. 15 U.S.C. § 80a-35(b)(2) (1970).

language obviously did not altogether remove approval by directors as a factor in determining whether an advisory fee was improper, it did prevent such approval from leaving "waste" as the only ground upon which to attack an advisory fee.<sup>46</sup> Therefore, notwithstanding statements by the Senate Committee reporting on the bill that section 36(b) was "not intended to shift the responsibility for managing an investment company in the best interest of its shareholders from the directors of such company to the judiciary,"<sup>47</sup> and that a "responsible determination regarding the management fee by the directors including a majority of disinterested directors is not to be ignored,"<sup>48</sup> it is clear that Congress felt compelled to recognize what the Commission had described as "the ineffectiveness of shareholder and directorial approval as a restraint on management compensation in the investment company industry."<sup>49</sup>

Additional, albeit more limited, amendments to the Investment Company Act were made in 1975 as part of the Securities Acts Amendments.<sup>50</sup> Again, while these amendments on their face placed increased emphasis upon the role of disinterested directors in protecting investment company shareholders against possible abuses by the company's management, there appears to have been a congressional determination that the discretion exercised by such directors should be limited. The 1975 amendments included the addition of section 15(f) to the Act, which in effect permits an investment adviser of a registered investment company to realize a profit on the sale of its business provided certain conditions are met.<sup>51</sup> This provision was enacted after the Second Circuit Court of Appeals had held in *Rosenfeld v. Black* that a breach of fiduciary duty on the part of a mutual fund's investment adviser could result where the adviser realized a profit in connection with its being replaced by another adviser.<sup>52</sup>

One of the conditions upon the applicability of section 15(f) to sales of advisory businesses is that, for at least three years following

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46. See text accompanying note 42 *supra*, and S. REP. No. 184, 91st Cong., 1st Sess. 15-16 (1969) [hereinafter cited as *1969 Senate Hearings*].

47. *1969 Senate Hearings*, *supra* note 46, at 7.

48. *Id.* at 6.

49. See text accompanying note 42 *supra*. Congress, as part of the 1970 amendments, also changed the "gross misconduct or gross abuse of trust" standard of the old § 36 to "breach of fiduciary duty involving personal misconduct" in the new § 36(a). 15 U.S.C. § 80a-35(a) (1970) (*amending* 15 U.S.C. § 80a-35 (1940)). See generally Freedman & Rosenblat, *Duties to Mutual Funds*, 4 REV. OF SEC. REG. 937, 938 (1971).

50. Securities Acts Amendments of 1975, Pub. L. No. 94-29, 89 Stat. 163 (1975).

51. 15 U.S.C. § 80a-15(f) (Supp. V 1975).

52. 445 F.2d 1337, 1343 (2d Cir. 1971). See also S. REP. No. 94-75, 94th Cong., 1st Sess. 71 (1975).

the sale, disinterested persons must comprise at least seventy-five percent of the board of directors of the investment company of which the seller served as adviser. Furthermore, section 16(b) of the Act was amended at the same time to provide in effect that, if compliance with the seventy-five percent requirement of section 15(f) necessitates the election of additional disinterested directors, those new directors must be selected and proposed for election by a majority of the disinterested directors which the company already has.<sup>53</sup>

Even in the narrow area of sales of advisory businesses, however, the reliance placed upon disinterested directors to protect investment company shareholders is limited by restrictions upon the amount and type of compensation which the directors can allow an investment company to pay to either the old or the new adviser. Specifically, section 15(f) permits a sale of an advisory business at a profit only if the sale does not result in an "unfair burden" upon the investment company.<sup>54</sup> "Unfair burden" is defined explicitly to include any arrangement for two years after the sale whereby the selling investment adviser receives any compensation from the investment company other than payments for bona fide services.<sup>55</sup> In addition, the enactment of section 15(f) in 1975 was accompanied by another amendment of section 15(c) to provide in effect that investment company directors, in determining what fee the company should pay its investment adviser, cannot take into account any price the adviser might have paid to acquire its business from the company's previous investment adviser.<sup>56</sup>

#### JUDICIAL OPINIONS

As suggested above, the framers of both the original Investment Company Act of 1940 and subsequent amendments to the Act recognized the limitations of unaffiliated and disinterested directors in protecting investment company shareholders with regard to conflicts of interest on the part of the company's management. They sought to compensate for these limitations by providing for a variety of regulatory safeguards in the Act. Nonetheless, in an industry as complicated and sophisticated as the investment company industry, it was perhaps inevitable that a practice involving a conflict of interest would develop which was not specifically regulated by the

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53. 15 U.S.C. § 80a-16(b) (Supp. V 1975).

54. *Id.* § 80a-15(f)(1)(A).

55. *Id.* § 80a-15(f)(2)(B).

56. *Id.* § 80a-15(c). See also note 35 *supra* and accompanying text.

Act, and where reliance would have to be placed upon unaffiliated or disinterested directors to determine the propriety of the practice with regard to individual investment companies. Accordingly, the role of such directors is central in the series of judicial opinions dealing with the issue of whether the management of an open-end investment company, or mutual fund, is free to engage in either customer-directed "give-up"<sup>57</sup> or reciprocal brokerage<sup>58</sup> practices in order to encourage sales of the mutual fund's shares, or whether, instead, brokerage commissions must be "recaptured" by the fund to the extent possible<sup>59</sup> in order to reduce its brokerage costs.

The conflict of interest faced by a mutual fund's investment adviser with regard to this issue is manifest. Since the fees earned by mutual fund advisers are based upon a percentage of the fund's assets, the allocation of brokerage commissions generated in connection with the fund's portfolio transactions to broker-dealers as a reward for those broker-dealers' sales of the fund's shares would clearly benefit the adviser by tending to increase the amount of the fund's asset base and hence the amount of the advisory fee. Any benefit to a mutual fund's shareholders resulting from growth of the

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57. Prior to the elimination of fixed stock exchange commission rates, mutual funds and other large institutional investors frequently had to pay much higher brokerage commissions for their portfolio transactions than would otherwise have been necessary. Since mutual funds' brokerage business was thus highly profitable to broker-dealers, mutual fund managers were in a position to demand that executing broker-dealers "give up" a portion of their commission to other broker-dealers who had no part in the transaction which generated the commission, but whom the mutual fund manager wished to reward for selling shares of the fund to the public. The New York Stock Exchange abolished such give-ups in December, 1968, and the other stock exchanges took similar action a short time later. See *Tannebaum v. Zeller*, 552 F.2d 402, 408 (2d Cir.), cert. denied, 98 S. Ct. 421 (1977).

58. "Reciprocal brokerage" involves directing a mutual fund's portfolio orders to a particular broker-dealer as a reward for that broker-dealer's sales of the fund's shares, without necessarily asking that the commission be shared with any other broker-dealer. Reciprocal brokerage practices in the mutual fund industry were effectively prohibited by the NASD in 1973, NASD Rules of Fair Practice, Article III, Section 2, after the SEC concluded that such practices could lead to a number of abuses and should be eliminated. See *Statement of the SEC on the Future Structure of the Securities Markets*, February 2, 1972, at 19, 37 Fed. Reg. 5286, 5290-91 (1972). However, the Commission later held public hearings to consider suggested interpretations and amendments of the NASD rule which would have the effect of permitting reciprocal brokerage practices under at least some circumstances. See *Securities Exchange Act Release No. 34-10867*, June 20, 1974, 39 Fed. Reg. 24544 (1974). To date, the Commission has not announced any conclusions resulting from those hearings.

59. "Recapture" of brokerage commissions could be achieved where the mutual fund's investment adviser, or an affiliate of the adviser, is a broker-dealer able to execute the fund's portfolio orders; a portion of the commissions paid to this broker-dealer could be credited against the advisory fee. The various (and changing) legal considerations associated with such an arrangement are discussed in *Tannebaum v. Zeller*, 552 F.2d 402, 407-09 (2d Cir.), cert. denied, 98 S. Ct. 421 (1977). See also *Securities Exchange Act Release No. 34-12055*, January 27, 1976, 41 Fed. Reg. 8075 (1976) and *Securities Exchange Act Release No. 34-13388*, March 18, 1977, 42 Fed. Reg. 16746 (1977).

fund's asset base is, on the other hand, debatable.<sup>60</sup> Conversely, if the fund followed a brokerage policy designed to result in lower brokerage costs at the expense of providing extra incentives for broker-dealers to sell shares of the fund, shareholders would clearly enjoy the benefit of reduced fund expenses. However, any benefit to the fund's management would be indirect at best since such benefit for the most part could derive only from the possibility that lower brokerage costs would to some extent make the fund more attractive to investors.

Because the Investment Company Act contains no provision specifically addressing the question of when, if ever, the management of a mutual fund must permit the fund to avail itself of a possible opportunity to recapture brokerage commissions, the courts which have considered the issue have had to determine whether failure to recapture results in a breach of fiduciary duty within the meaning of section 36 of the Act.<sup>61</sup> The first appellate decision in this area was that of the First Circuit Court of Appeals in the case of *Moses v. Burgin*.<sup>62</sup> There, the court held that a mutual fund's management which chose not to have the fund attempt to recapture brokerage commissions breached its duty to the fund under section 36 of the Act<sup>63</sup> not because recapture necessarily would have been desirable, but rather because the fund's management failed properly to advise the unaffiliated directors of the *possibility* of recapture.<sup>64</sup> After stating that "[i]f management does not keep [unaffiliated] directors informed they will not be in a position to exercise the independent judgment that Congress clearly intended,"<sup>65</sup> the court said:

[I]t was the directors of Fund, not Management, who were the ones to make the decision [regarding recapture]. That they need not have decided to experiment is irrelevant. The [district]

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60. The question of whether, and if so to what extent, increased sales of mutual fund shares benefit fund shareholders was one of a number of issues considered by the SEC in connection with public hearings held in November, 1976. See Investment Company Act Release No. IC-9470, October 4, 1976, 41 Fed. Reg. 44770 (1976). The Commission has not yet announced any conclusions with respect to this issue. See also Freeman, *The Use of Mutual Fund Assets to Pay Marketing Costs*, 9 Loy. Chi. L.J. 533 (1978).

61. 15 U.S.C. § 80a-35 (1970). See also text accompanying note 37 *supra* and note 49 *supra*.

62. 445 F.2d 369 (1st Cir. 1971).

63. This case arose before § 36(b) was added to the Act in 1970. See text accompanying notes 37-38 *supra*.

64. The court did indicate that if recapture was freely available to the fund, the directors had no discretion to forego recapture. 445 F.2d at 374. However, the court made clear that its view in this regard was based upon the terms of the fund's charter.

65. 445 F.2d at 377.

court's ruling does not excuse Management from its failure to disclose and so permit the unaffiliated directors to decide.<sup>66</sup>

Similar reasoning was subsequently adopted by the Second Circuit Court of Appeals in the case of *Fogel v. Chestnutt*.<sup>67</sup> As in *Moses*, the *Fogel* court in effect conceded that there might have been sound business reasons militating against a decision for the fund to seek to recapture brokerage commissions.<sup>68</sup> Nonetheless, the court held that the mutual fund's management had breached its fiduciary duty under section 36 of the Investment Company Act by failing to communicate effectively the possibility of recapture to the fund's disinterested directors.<sup>69</sup>

Since the decisions in both *Moses* and *Fogel* turned upon a failure to provide sufficient information to investment companies' unaffiliated directors,<sup>70</sup> those courts did not have to address the seemingly more difficult question of whether the unaffiliated directors would have been in a position to protect the interests of shareholders adequately if they *had* been fully informed by the funds' management concerning the possibility of recapture. That question did arise, however, in connection with the opinion of the Second Circuit Court of Appeals in *Tannenbaum v. Zeller*.<sup>71</sup> Like *Moses* and *Fogel*, *Tannenbaum* dealt with the issue of whether a mutual fund's failure to recapture brokerage commissions resulted in a breach of fiduciary duty within the meaning of section 36 of the Investment Company Act. However, in *Tannenbaum* the court concluded that the mutual fund's disinterested directors, who constituted a majority of the fund's board,<sup>72</sup> had been "fully informed by the adviser and the interested directors of the possibility of recapture and the alternative uses of brokerage . . . ."<sup>73</sup> Nonetheless, the court made clear that supplying full information to the disinterested directors would not have been enough to avoid a breach of duty on the part of the fund's management if the decision to forego recapture had not also been a reasonable business decision made by disinterested directors

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66. *Id.* at 383.

67. 533 F.2d 731 (2d Cir. 1975).

68. *Id.* at 756.

69. *Id.* at 748-49.

70. *See also* *Galfand v. Chestnutt Corp.*, 545 F.2d 807 (2d Cir. 1976), holding in part that a mutual fund's investment adviser breached its duty to the fund under § 36(b) of the Act by prevailing upon the fund's directors to approve a modification of the advisory contract without making clear to the directors that the modification would result in the adviser not having to make a rebate of expenses to the fund which otherwise would be required.

71. 552 F.2d 402 (2d Cir.), *cert. denied*, 98 S. Ct. 421 (1977).

72. *Id.* at 411.

73. *Id.* at 427.



who "were not dominated or unduly influenced by the investment adviser."<sup>74</sup> In concluding that the fund's board of directors was in fact a "well-qualified" one which "did not merely rubber-stamp the recommendations" of the management company,<sup>75</sup> the court reviewed in considerable depth the nature of the consideration given to recapture by the disinterested directors.<sup>76</sup> That consideration involved the formation of a subcommittee which examined, among other things, relevant SEC releases and an opinion of counsel, and which reported to the full board of directors.<sup>77</sup>

#### POSSIBILITY OF SUBSTITUTING JUDGMENT OF GENUINELY INDEPENDENT DIRECTORS FOR REGULATORY STRICTURES

If independent investment company directors—that is, those who are not only technically disinterested but also, in the words of the *Tannenbaum* opinion, are "well-qualified" and "not dominated or unduly influenced by the investment adviser," and do "not merely rubber-stamp" the investment adviser's recommendations—can be relied upon to protect the interests of the company in an area as complicated and filled with conflict of interest as a decision concerning the desirability of recapturing brokerage commissions, it is reasonable to suppose that such independent directors could be relied upon to protect the interests of investment companies with respect to matters which are now the subject of regulatory limitations.<sup>78</sup> A shift, however limited, from reliance upon regulatory strictures to reliance upon independent directors' discretion in determining the propriety of various types of investment company transactions and activities could be of significant benefit to not only the investment company industry, but also public investors and the SEC.

For example, legal fees associated with the filing of applications for Commission orders under sections 17(b) and 17(d) of the Investment Company Act to permit transactions with affiliated persons<sup>79</sup> undoubtedly represent, by themselves, a significant cost to the investment company industry in the aggregate. A less obvious, but potentially more troubling, cost might result to the extent that, because applications under these and other sections of the Act

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74. *Id.* at 418.

75. *Id.* at 427.

76. *Id.* at 419-26.

77. *Id.*

78. For discussion of various regulatory limitations, see text accompanying notes 12-20 *supra*.

79. For further discussion of these provisions, see text accompanying notes 12-13 *supra*.

sometimes are so complex that their processing by the Commission staff can involve considerable delay, there might be cases where investment companies choose to forego transactions which would be in the interest of their shareholders but for which a Commission order would be necessary. Manifestly, the burden upon the investment company industry resulting from the regulatory requirements of the Investment Company Act, and the burden upon the SEC resulting from the administration of those requirements, would be alleviated to the extent that investment companies having a majority of independent directors could be exempted, either by legislation or SEC rules,<sup>80</sup> from some of the Act's restrictions.<sup>81</sup>

The difficulty, of course, lies in defining what is meant by "independent" investment company directors. Clearly it would not be feasible to adopt the approach used by the *Tannenbaum* court in deciding whether an investment company's directors are independent, since that approach involved a detailed examination by the court of the nature of the consideration given to a particular issue by the company's directors.<sup>82</sup> Such examination of directors'

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80. The SEC has broad power under § 6(c) of the Investment Company Act to grant exemptive relief from provisions of the Act. For further discussion of the SEC's power to grant exemptive relief, see note 15 *supra*. However, in view of the far-reaching nature of the exemptions being discussed here, it might be more appropriate to provide such exemptions by means of legislation, whether or not the SEC has the power to provide them administratively.

81. An alternative approach would be to allow an investment company with less than a majority of independent directors to qualify for the exemptions also, provided that those matters as to which exemptions were provided were approved by a majority of the directors who *were* independent. This would be consistent with the treatment of investment advisory and principal underwriting contracts under § 15(c) of the Act and the selection of independent auditors under § 32(a) of the Act. For further discussion of these provisions, see note 34 *supra*.

82. In this connection, it is interesting to note that, after deciding *Tannenbaum*, the Second Circuit Court of Appeals held in *Lasker v. Burks*, No. 77-7060, 46 U.S.L.W. 2388 (decided Jan. 11, 1978), that a mutual fund's disinterested directors could not terminate a non-frivolous shareholder's derivative action against the fund's investment adviser and interested directors. The suit involved an allegation that the defendants had violated, among other things, their fiduciary duty under the Investment Company Act with respect to certain investments made by the fund in securities issued by the Penn Central Company. The district court had held that the disinterested directors could bar further prosecution of the action, after finding that those directors had in fact acted independently of management with respect to the matter. The court of appeals, without considering whether the district court had been correct in finding the disinterested directors to be genuinely independent, concluded that, since statutorily disinterested directors were intended to provide a check upon the actions of directors controlled by the investment adviser, it "would be contrary to the legislative purpose to permit the independent minority to be used to approve majority action so that no stockholder complaint could survive that approval." *Id.* at 2388. The court noted that in "the ordinary routine business of running an investment trust, the disinterested directors must constantly deal with interested directors in a spirit of accommodation," and that "they are compelled for the most part to rely on the information and expert advice provided by the adviser and the majority directors." *Id.* at 2389. The court then stated that it "is asking too

deliberations by the Commission on a case-by-case basis would appear at least as burdensome as the present system of making transactions subject to Commission scrutiny by means of applications for orders permitting the transaction.

Nor would it seem fruitful to attempt to avoid such a case-by-case analysis by formulating general standards regarding the type of consideration directors must give to various issues in order to be regarded as independent. The type of consideration which would be appropriate in each case obviously would depend upon the nature of the matter being considered, and the potential variety of such matters is limited only by the bounds of the imagination of investment company managers. The difficulties associated with an attempt to formulate standards regarding the type of consideration by disinterested directors which might permit the substitution of such directors' judgment for that of the SEC with regard to matters now subject to regulation is suggested by the discussion of the Reporters for the American Law Institute's Federal Securities Code project<sup>83</sup> of their attempt to develop a new approach to the treatment of joint transactions between investment companies and affiliated persons under section 17(d) of the Investment Company Act.<sup>84</sup> After describing section 17(d) as having been, "because of its generality, perhaps the single most troublesome provision in the entire statute,"<sup>85</sup> the Reporters said that they had been prompted

to attempt an entirely new approach to the section designed to clarify its coverage and relax its strictness to the extent of interposing the noninterested directors to blunt the intrusion of court or Commission in reviewing a challenged transaction. But disagreement among the Consultants and Advisers with respect to an acceptable (let alone a desirable) solution of the problems—together with the rejection of proposed changes by spokesmen for the industry—has induced the Reporters, particularly in the light of the Code's limited approach to substantive revision of the Investment Company Act, to leave §17(d) substantially as it is today.<sup>86</sup>

Accordingly, it might be more useful to attempt to ascertain which disinterested directors can be regarded as genuinely indepen-

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much of human nature to expect that the disinterested directors will view with the necessary objectivity the actions of their colleagues in a situation where an adverse decision would be likely to result in considerable expense and liability for the individuals concerned." *Id.*

83. AMERICAN LAW INSTITUTE FED. SEC. CODE (Tent. Draft No. 6, April 1, 1977) [hereinafter cited as ALI DRAFT].

84. This provision is discussed at note 13 *supra* and accompanying text.

85. ALI DRAFT, *supra* note 83, at 182.

86. *Id.* at 183-84.

dent by focusing the inquiry instead upon the types of individuals who would be qualified to act as independent directors, and upon the kinds of *procedures* they should follow in connection with their deliberations.

Qualification standards, of course, already exist in a number of other contexts. For example, the SEC has prescribed examination requirements under the Securities Exchange Act of 1934<sup>87</sup> with regard to broker-dealers.<sup>88</sup> Moreover, physicians, attorneys, and members of other professions must meet various education requirements and pass examinations. However, it may be considerably more difficult to prescribe qualification standards for independent investment company directors. The potential variety of decisions which such a director could be asked to make in connection with his duties is so great that it might not be feasible to devise an examination to test his qualifications, as has been done with respect to broker-dealers. Furthermore, although such professionals as physicians and attorneys might be called upon to deal with a wide variety of problems, there exists at least general agreement as to the kind of education and basic knowledge which an individual should possess in order to practice those professions. It is not clear that such an agreement could be obtained with respect to independent investment company directors. For example, a requirement that such a director have an educational or practical background in business, finance, or law would apparently have excluded at least three of the twelve directors which the *Tannenbaum* court in effect found to be independent.<sup>89</sup> In this connection, it might be noted that in 1976 legislation was introduced in the Senate<sup>90</sup> to amend the Investment Advisers Act of 1940<sup>91</sup> to provide, among other things, authority for the SEC to prescribe qualification standards with regard to investment advisers. The legislation was reported favorably by the Senate committee<sup>92</sup> but was not passed. In opposing the bill, Senator Helms, in his minority views, quoted the following testimony by John L. Casey, Chairman of the Investment Counsel Association of America:

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87. 15 U.S.C. §§ 78a *et seq.* (1970).

88. 17 C.F.R. § 240.15b8-1 (1977). The SEC examination requirements relate only to broker-dealers who are not members of the National Association of Securities Dealers, Inc.; that organization, however, administers an examination for membership.

89. 552 F.2d 402, 411 n.9. One such director was president of a science foundation and a former college president; another was an authority on medical questions; and a third was a consultant on scientific matters.

90. S. 2849, Calendar No. 866, S. REP. No. 94-910, 94th Cong., 2d Sess. (1976).

91. Investment Advisers Act, ch. 686, title II, § 201 54 Stat. 847 (1940) (current version at 15 U.S.C. §§ 80b-1 *et seq.* (1970), *as amended in* 15 U.S.C. §§ 80b-1 *et seq.* (Supp. V 1975)).

92. S. REP. No. 94-910, 94th Cong., 2d Sess. (1976).

One point on qualification is that investing is certainly not a precise science, and the disclosure route of qualifications may well be better than prescribing that somebody have a background in fundamental analysis. If we are the purists in the industry, nevertheless we recognize that there ought to be room for people who suggest random selection, or the seat-of-the-pants investor, or the technical point and figure artist or even the astrologer or the I-Ching coin tosser.<sup>93</sup>

Nonetheless, it might not be totally fruitless to pursue the possibility of considering a director's background and experience as one measure of whether he can be regarded as independent. Even if generally applicable standards could not be formulated, it might be possible to devise a procedure whereby the SEC would determine in individual cases whether a person was qualified to serve as an independent director. Although it is unlikely that either the investment company industry or the SEC would relish the prospect of the Commission passing upon the qualifications of investment company directors, it should be emphasized that such consideration by the SEC would be only for the purpose of deciding whether the directors were *independent* and, thus, whether the company which they serve would qualify for exemption from one or more provisions of the Investment Company Act. Presumably, a director which the SEC did not, for this purpose, find qualified to act independently would not thereby be precluded from serving as either an interested or a disinterested investment company director in accordance with the present provisions of the Act.<sup>94</sup>

Of course, having the SEC determine the qualifications of independent directors even on a case-by-case basis would require the Commission to formulate some criteria for measuring such qualifications, even though the criteria could be modified in light of the facts of a particular case. Since, as suggested above, the formulation of any standards in this area would be difficult at best, it may be useful to consider supplementing the SEC's determinations with regard to the qualifications of independent directors by prescribing

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93. *Id.* at 18.

94. Germany's counterpart of the Investment Company Act provides that, in general, the members of an investment company's board of supervisors "are to guarantee a safeguarding of the interests of the shareholders by virtue of their personal integrity and their special knowledge," and that the "bank supervisory authority shall be notified without delay of the appointment of the board of supervisors and of every change of the members of the board of supervisors." *Law Concerning Capital Investment Companies, First Chapter, Section 4* (1970), translated in TORMANN, *THE INVESTMENT INSTITUTIONS* 106 (1973). However, it is not clear whether this provision gives the German authorities power to pass upon the qualifications of the members of an investment company's board of supervisors.

procedures which independent directors should follow in connection with their decision-making. The formulation of these standards might be somewhat less difficult than the formulation of standards defining the qualifications of independent directors.

For example, a number of observers of the investment company industry have suggested that an investment company's disinterested directors should have the advice of either their own counsel or counsel for the fund who is separate from the management's counsel.<sup>95</sup> The absence of independent counsel was one of the factors cited by the SEC in PPI as contributing to the relative ineffectiveness of unaffiliated directors.<sup>96</sup> It would seem that the value of such counsel in helping to ensure independent consideration of issues by the disinterested directors is beyond dispute, if only because independent counsel will tend to marshal arguments to balance those presented by management in matters involving conflicts of interest, and will help ensure that management's position is thoroughly examined.

The absence of independent staff on the part of unaffiliated directors was also noted by the Commission in PPI.<sup>97</sup> It might be useful for the independent directors to have their own staff, perhaps on a periodic consulting basis, in addition to legal counsel. For example, accountants who are not employed by management could be of significant assistance to the independent directors in connection with their consideration of complex financial matters.

Finally, it would seem appropriate to insist that independent directors conduct at least a portion of their deliberations in meetings not attended by interested directors or representatives of management. This procedure appears to have been followed by the independent directors in *Tannenbaum*,<sup>98</sup> and it likely would be useful if only because of its tendency to encourage frank discussion of management's position.

#### CONCLUSION

At least until additional consideration has been given to the subject, it will not be possible to suggest a general means of determining whether investment company directors are genuinely independent. Even if such consideration is given, there is no assurance that it will

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95. See, e.g., Lipton, *Directors of Mutual Funds: Special Problems*, 31 *BUS. LAW.* 1259, 1262 (1976).

96. PPI, *supra* note 24, at 130-31. For further discussion of these factors, see notes 26-28 *supra* and accompanying text.

97. *Id.*

98. 552 F.2d 402, 421 (2d Cir.), *cert. denied*, 98 S. Ct. 421 (1977).

generate a practical set of standards. However, if the independence of disinterested investment company directors could be assured to a greater degree than has heretofore been the case, it might be feasible to relax some of the regulatory strictures presently imposed by the Investment Company Act and substitute the judgment of those independent directors. The benefits which such a substitution could produce for the investment company industry, public shareholders, and the federal government would make an attempt in this area well worthwhile.