

burdens on issuers. This effort will be expedited as much as possible within the limitations of our resources.

3. Prior to the introduction of H.R. 9510 on May 1, 1967, the Investment Company Institute made two proposals to the Commission as alternatives to the provisions of the Bill relating to advisory fees. The Institute's first alternative would have increased the number of independent directors required to be on an investment company board of directors from 40 percent to a majority of the board. This requirement, for the most part, reflects the existing industry practice. In addition, the Institute suggested an elaboration of a relatively minor part of our own legislative proposals, which would merely tighten the standard for the independence of unaffiliated directors by requiring them to be "disinterested" persons. Although we believe that enactment of this proposal would be helpful in certain other areas of investment company affairs, unaffiliated directors cannot effectively deal with problems in the advisory fee area. As we have previously pointed out, the problem is not the unwillingness of the unaffiliated directors to deal with the questions, it is their inability to do so.

After the Commission rejected this proposal as wholly inadequate, the Institute submitted a second "alternative" to the Commission's proposal. This alternative would have required that a majority of the independent directors of an investment company, before approving an advisory contract, find in the exercise of their business judgment that the compensation payable to the adviser is reasonable. Under this proposal the Commission would be precluded from taking any enforcement action. Only the investment company or a fund shareholder would be able to institute a suit alleging that the directors had "abused their business judgment." However, a court could not render judgment for the plaintiff on the ground that the fee was unreasonable, even if it found that the evidence supported that conclusion, unless the plaintiff proved by "clear and convincing evidence" that the director's approval of the advisory contract was a "clear abuse of business judgment." This proposal may have the virtue of recognizing the elementary principle that the fiduciary's fees must be reasonable and that it is a proper function of the courts to enforce this obligation. But it would, in fact, hamstring the courts in the exercise of this traditional role by preventing them from acting unless the evidence was "clear and convincing" that the approval of directors was "a clear abuse of business judgment."

This proposal would have the effect of putting the directors, particularly the unaffiliated directors, on trial, rather than the fees. It would neither be fair to the directors nor lead to an effective enforcement. As a practical matter, it would provide an even greater degree of insulation from judicial scrutiny than now exists as long as the defendants could show that the directors had gone through the ritual prescribed by careful counsel to wrap the fees in the protective cloak of "business judgment."

For these reasons the Commission did not and does not now believe that the proposals of the Institute constitute a viable alternative to the provisions of H.R. 9510 with respect to advisory fees.

We do not believe that Mr. Robert Haack, in his statement to the Subcommittee on behalf of the New York Stock Exchange intended to advance proposals different from those that had been advanced by the Institute and rejected by the Commission. Mr. Haack did, however, describe the Institute's proposal as permitting the courts to enforce a standard of reasonableness if it found an "abuse of business judgment." Such a proposal, like the Institute's proposal, would still put the directors, rather than the fees, on trial. It also implies that the directors are in a position to make a "business judgment" in approving an advisory contract when in fact they have no realistic alternative but to accept the contract offered by the adviser. But the Institute's proposal did not go even that far. It would preclude enforcement of the standard of reasonableness unless the court could find "clear and convincing evidence", which showed a "clear abuse of business judgment."

4. In his letter of October 18, 1967, Deputy Attorney General Warren Christopher, comments principally on the Commission's recommendations for a 5 percent limitation on the basic sales charge for mutual fund shares and for a standard of "reasonableness" to be applied to advisory fees.

With respect to sales loads, the Department of Justice notes that the proposed 5 percent limitation is not inconsistent with the basic concept of the Investment