

I believe that these statutes would make it even more difficult for mutual fund shareholders to challenge advisory fees than has been true under the judicial doctrines. Thus, full disclosure to all directors in the case of an investment company—will end the matter if the directors act in “good faith” which ordinarily they could show, for “good faith” is a less rigorous standard than “fairness.” In all events, ratification by the shareholders after disclosure—which, of course, the Investment Company Act authorizes—would be conclusive even if director approval were not. Accordingly, these statutory standards would not ease the objector’s burden, and probably they would increase the effort necessary to win a judgment for the fund or affect a satisfactory settlement.

(c) Finally, I point out a new and somewhat unnoticed development occurring in the state law of fiduciary duty which, ultimately, is involved in any determination of reasonable management compensation. This is the tendency of some courts to apply to situations, involving definite although subtle interest conflicts, the famous “business judgment” test. This concept originally meant that if the directors of a corporation, acting without any conflict of interests or otherwise in breach of duty, approved a transaction, it is immune from attack even if it proves to be wrong, even disastrous to the corporation. Originally, it was not applied when directors did have an interest conflict; there the orthodox rule required full “judicial scrutiny” of the transaction to discover and extirpate any taint of wrongdoing. Several relatively recent decisions in corporation law are susceptible to the interpretation that the business judgment rule has been applied beyond its original contours to uphold a transaction in which interest conflicts inhered. *Warshaw v. Calhoun*, 221 A.2d 487 (Del. Sup. Ct. 1966); *Case v. New York Central R.R.*, 15 N.Y.2d 607, 256 N.Y.S.2d 607 (1965), cf. *Cheff v. Mathes*, 199A.2d 548 (Del. S. Ct. 1964). Although these decisions deal with problems altogether outside the mutual fund field, I believe that they point a warning signal for Congress to consider in determining whether legislation on mutual fund fees is necessary. Should this line of decisions grow, I believe that it would be an easy step for a court to rule that the compensation level for an advisory organization lies within the business judgment of the directors, or at least those not affiliated with the advisor-underwriter. *Saxe v. Brady’s* language, already quoted, is indeed a bridge to that result since it frames the test in terms of whether “ordinary businessmen” would differ on the sufficiency of the terms. I say this even though taking full account of *Saxe v. Brady’s* significant warning that “the business community might reasonably expect that at some point” the management fee would be adjusted downward to “reflect the diminution in the cost factor.” 40 Del. Ch. 474, 498, 184 A.2d 602, 616-617 (Del. Ch. 1961).

3. *The reasonableness standard of the bill*

Despite some attack upon the supposed vagueness of the “reasonableness” standard, the test is as precise as it is possible in an area requiring fact determinations in particular cases. Indeed, the test of management compensation in state corporate law is one of “reasonableness”, with additional content derived from the subsidiary standards applied in the mutual fund cases and by manipulating the burden of proof depending upon ratification. Thus, the general standard is the only conceivable one which could do justice to all situations covered by it.

In my judgment, the bill appropriately identifies the components of the “reasonableness” standard without limiting the factors to be considered by the courts. The four designated factors are the ones which judicial decisions and informed discussion have viewed as significant. Flexibility is guaranteed by subsection (d) (2) (E) referring to “such other factors as are appropriate and material.”

4. *Burden of proof*

My chief doubt about the provision lies in its placing the burden of proving unreasonableness on the party objecting to the fee level. Even when reasonableness is the criterion, it will be difficult for the outsider to secure the data which will enable him to establish the unreasonableness of compensation, especially in light of the factors comprising reasonableness under the statutes. Most of these factors relate to internal matters, information on which is not likely to be available to the objector. For instance, it will require considerable effort to obtain, if the effort is successful, facts bearing on the quality of services rendered to the fund or to the advisor’s other clients ((d) (2) (B)), economies of scale within a complex of funds managed by a single advisor ((d) (2) (C)),