

velop because some representatives of the industry have hypnotized themselves into thinking that the formal structure they have woven produces a true arms length bargain merely because the formality of approval by independent directors was observed. Not all industry representatives agree, as demonstrated by testimony of Investment Company Institute spokesman before this committee. At the very least, this bill will achieve the desirable goal of clarifying for the mutual fund director just what is his obligation. The experience of the investment company industry has demonstrated that however well-intentioned may be the so-called unaffiliated or independent directors, they have not succeeded in protecting shareholders from whatever fee the investment adviser has asked.

Of course, the protection of the courts may be sought to protect the fund and the shareholders from paying an excessive fee. But, again, we cannot ignore history. It must be apparent to anyone who has studied the history of the mutual fund litigation which has occurred since 1960, that the courts are ill-disposed to invoke their judgment in the area of compensation. Once the fee imposed by the investment adviser has been adopted by the Board of Directors, and approved overwhelmingly by the shareholders—a simple ritualistic exercise—the courts will upset this judgment only if it is proven by the person challenging the fee that the fee is so excessive that it constitutes waste. Judge Friendly, in a statement submitted to the Senate Banking and Currency Committee during its hearing on S. 1659, (at page 1015) and during the course of these hearings, characterized the burden of the plaintiff in attempting to show such waste as being forced to prove that the fee was “excessively excessive” or “unreasonably unreasonable.” Such a task is so burdensome as to be almost impossible. Thus, no plaintiff has prevailed in any such suit despite the fact that in one case, Chancellor Seitz observed that while he could not find as a matter of law that the fee charged in that case, amounting to the prevailing industry rate of one-half of one percent, constituted waste it was fast approaching that standard. *Save v. Brady*, 40 Del. Ch. 474, 498, 184 A.2d 602, 616-17 (Del. Ch. 1961)

The combination of hurdles presented to the shareholders of a fund has proven insurmountable. The investment adviser feels no obligation itself to protect the best interests of the fund of the shareholder when the fee is established, assigning that task to so-called independent directors. The independent directors have simply not been up to the task. Finally, under the existing state of the law, the courts have been unable to provide the necessary protection. The only alternative then, is new federal legislation which will create a federal standard by which all management fees must be tested. I submit that proposed amendment to § 15(d) of the Act is the most modest approach to this problem. The bill merely tells us that all compensation paid by the fund to the adviser shall be reasonable and sets forth an outline of criteria to assist a tribunal in making that factual determination. It leaves with the person challenging that fee the burden of proving by the preponderance of the evidence, that the fee is unreasonable. This is consistent with the approach undertaken by Congress in 1940 when it enacted the Investment Company Act. That statute outlawed what were the most flagrant conflicts of interest in the investment company interest. The determination of the management fee is a clear conflict of interest which is incapable of redress under existing law.

Personally, I believe this proposal is too modest, and I know that my view on this is shared by a number of my colleagues. Nonetheless, I think it not unreasonable to believe the bill stands an excellent chance of successfully accomplishing its purposes. First, it replaces an unrealistic state law standard with a federal standard for determining the excessiveness of management compensation. Second, the statement in the bill with respect to the burden of proof although in my opinion unsatisfactory, at least overcomes the extraordinary burden imposed upon plaintiffs under present law, whereby if the fund was successful in obtaining shareholder ratification for the management fee, then the burden upon the plaintiff is to prove that the fee was so excessive that no reasonable person could have adopted such a fee. Excessive management fees have often been sustained on the basis of the fact that the overwhelming number of shareholders approved of the transaction. Shareholder ratification under these circumstances constitutes a hollow act. Shareholders of a fund are asked, by means of a proxy statement to approve of the appointment of an advisor at a specified fee or to disapprove. They are left with no alternatives in between. They cannot renegotiate the fee imposed by the advisor. The mutual fund shareholder is not in the same position as a shareholder in other corporations in this matter. Elsewhere, he may