IDC Independent Directors Council

Promoting Excellence in Fund Governance

IDC Chairman Remarks at 2009 IDC Conference

Opening Remarks of Michael S. Scofield

Chair, Independent Directors Council

Independent Chair, Evergreen Funds

2009 Investment Company Directors Conference

November 12, 2009

Good morning and welcome to IDC's 2009 Investment Company Directors Conference. I am Mike Scofield, Chair of the IDC and Independent Chair of the Evergreen Funds.

It has been quite a year, hasn't it? Considering the extraordinary market events, Congress's plans for financial services regulatory reform, and the Supreme Court case, Jones v. Harris, we have a lot to talk about. And this annual conference offers us all an opportunity to reflect on these matters – to discuss and consider their implications for the fund industry and the work we do as fund directors.

Last night, ICI's President and CEO, Paul Stevens, offered interesting observations about systemic risk in the financial markets. This morning's panels will focus on the new era for asset management that the crisis has brought about.

Two SEC officials are joining us as well: Buddy Donohue, the Director of the SEC's Division of Investment Management will share his thoughts during lunch today. Tomorrow morning, we'll hear from SEC Commissioner Troy Paredes.

You will find the program is full of opportunities to gain new insights about issues you may be grappling with on your own board, both through the panel discussions and your own conversations with fellow directors. The informal interactions and discussions which take place among fund directors at this conference can also be invaluable.

I have been attending this conference for a number of years, and I always go home with “take aways” that help me continue to improve as a fund director, as a board chair, and as a representative of fund shareholders. I trust that you, too, will leave the conference better informed and with new insights that you can take back to your own board rooms.

At this time, I would like to take just a few moments to comment on Jones v. Harris – a case of great importance to our industry and to us as fund directors.

Last week, I attended the oral arguments in the Supreme Court. The spirited questioning by the justices is fresh in my mind. I was encouraged to see their keen interest in matters so close to my professional heart. While, in the oral argument, there was not a major focus on the role of fund directors, I predict that the written opinion will recognize our crucial role rather than reassigning that role to trial judges.

As most of you know, Jones is an alleged excessive fee case – where plaintiffs sue a fund adviser claiming that the adviser breached its fiduciary duty by charging the fund an excessive advisory fee. The plaintiffs’ bar has been active in this area, but with little success. Nonetheless, they have managed to get this case before the Supreme Court. And the Court’s decision will have implications for the mutual fund industry and fund directors for many years to come.

The issue before the Supreme Court is this: What standard should a court apply when reviewing a claim of an excessive fee? Until Jones v. Harris, most cases were decided under the Gartenberg standard, which was articulated by the Second Circuit Court of Appeals nearly thirty years ago. That decision instructed courts to consider claims in light of a variety of factors. The SEC now requires directors to comment on those Gartenberg factors in annual shareholders’ reports. Shareholder interests have been well-protected by these legal mandates.

The plaintiffs’ lawyers want to trash these clear principles which have guided our decisions for so long. In their arguments before the Supreme Court, they have essentially dismissed the relevance of fund directors. They want to turn every fund’s advisory fee agreement into a federal case wherein a judge would substitute their own opinion of what is a “fair” fee, ignoring the countless hours directors devoted to reviewing the reams of data and other information relating to advisory contracts. But judges can’t possibly exercise the same quality of oversight as a fund’s independent directors.

IDC makes this point quite persuasively in its amicus brief. We argue that courts should defer to the business judgment of the fund directors who approved the advisory contract, absent a fundamental deficiency in the approval process. The brief describes the rigorous review, familiar to all of us, which directors undertake every year, noting that the process of preparing for the meeting at which the advisory contract is approved takes several months, and often the entire year. There may be several rounds of questions and answers regarding the appropriateness of all fees as well as investment strategies, risk-management controls and many other issues. Trial judges simply do not have the time or expertise to evaluate the large volume of information involved and weigh the many considerations

essential to the exercise of good business judgment.

John Donovan of Ropes & Gray, representing Harris Associates, made a telling point as he closed his oral argument: If the Court takes the plaintiffs' point of view – allowing judges, rather than directors, to decide what is an appropriate fee – then the Court would consign 8,000 funds to a trial. In that scenario, the only winners would be the class action attorneys. The mutual fund industry would become fertile ground for fee litigation, reducing choice and increasing costs for investors.

Based upon Mr. Donovan's brilliant oral argument and the amicus briefs submitted by IDC, ICI, the Mutual Fund Directors Forum and others in support of Harris, I believe the Supreme Court will grasp the importance of the role independent directors play in protecting the interests of almost 90 million fund shareholders and require significant deference to directors' business judgment.

The lawyers anticipate that the Court's opinion will be published in the early part of next year.

If you're interested in reading more about the case, including a transcript of the oral argument, you may go to IDC's website where you can find a Jones v. Harris resource page. We will continue to update the page with relevant developments.

In addition, IDC and ICI will host a one-day conference exploring the implications of Jones v. Harris soon after the Supreme Court issues its decision. So stay tuned.

Before I introduce our keynote speaker, I would like to thank you all for coming to the conference and hope you find it worthwhile. Amy Lancellotta and the IDC staff have put together a fine program which includes panel discussions of timely issues and distinguished guest speakers.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.