THE INVESTMENT LAWYER™

covering legal and regulatory issues of asset management

ASPEN PUBLISHERS Vol. 17, No. 8 • August 2010

When a Fund is Sued: An Independent Director's Guide to Fund Litigation—Part 2

by Robert W. Helm, William K. Dodds, David M. Geffen and Jeanette Wingler

This article explains what funds' independent directors should know about fund litigation. Part 1 appeared in the July 2010 issue of *The Investment Lawyer*, where the authors described the most-common types of claims against funds and the roles that independent directors play when these claims are asserted. The authors then described the differences between direct lawsuits against a fund and derivative lawsuits brought on behalf of a fund. Finally, in Part 1 of this article, the authors described how independent directors can form a special litigation committee with respect to a proposed lawsuit to recommend whether the fund should pursue the lawsuit and the possible benefits that can flow from such a committee.

Here, in Part 2, the authors describe the attorney-client privilege and when the privilege applies to protect the confidentiality of communications between an attorney and a client in the context of litigation against a fund. The authors then discuss the common interest

The authors are attorneys with Dechert LLP in the firm's financial services group or securities litigation group and practice in the firm's Boston, New York City or Washington, DC offices.

doctrine, which permits parties to a lawsuit to share privileged information without losing the confidentiality protection of the attorney-client privilege. The authors next cover the related topics of insurance and indemnification in the context of directors and fund litigation. Finally, the authors discuss payment of the settlement costs in fund litigation.

Attorney-Client Privilege in Fund Litigation

What is the Privilege?

The attorney-client privilege is a legal rule of evidence that protects the confidentiality of communications between an attorney and a client.[1] The privilege is one of the strongest privileges available under law.[2] Generally, in a lawsuit, the attorney-client privilege entitles a party to withhold from production to the other party confidential communications that seek or reflect legal advice.

The attorney-client privilege requires at least four elements: (1) a communication; (2) with an attorney or his or her subordinate; (3) in confidence; (4) for the primary purpose of securing an opinion of law, legal services or assistance in a legal proceeding.[3]

As a matter of procedure, the party invoking the attorney-client privilege bears the burden of persuasion. If disputed, the judge will determine whether a communication is privileged.

Availability of the Attorney-Client Privilege

The independent directors, interested directors, fund, Special Litigation Committee (SLC) or adviser may hire counsel to assist in fulfillment of their respective duties. If the requisite elements are met, the attorney-client privilege may be asserted by the independent directors, interested directors, fund, SLC or adviser to protect communications with their respective counsel. However, because one law firm may represent multiple parties, the ability to assert the attorney-client privilege may turn on the issue of who is the client with respect to a particular communication.

As a general matter, to the extent that any board materials or communications with one's counsel meet the requisite four elements, the fund or board may assert the privilege against outsiders, including the adviser. Communications between the board and counsel to the adviser generally are not privileged unless, as described below, they are subject to the common interest/joint defense exception.

Members of a board of directors normally cannot assert privilege against each other.[4] Nevertheless, a SLC, created to investigate, review and analyze the facts and circumstances surrounding a derivative demand letter, and its retained counsel have a privilege that may be asserted even against the board.[5] A SLC may waive that privilege, however, by sharing privileged documents and legal advice with the full board, if the interests of the SLC and one or more members of the board (for example, management directors) are adverse.[6]

ASPEN PUBLISHERS

THE INVESTMENT LAWYER
covering legal and regulatory issues of asset management

The Investment Lawyer (ISSN 1075-4512) (USPS P0000-062) is published monthly by Aspen Publishers, at 76 Ninth Avenue, New York, NY 10011. Postmaster: Send address changes to *The Investment Lawyer*, Aspen Publishers Distribution Center, 7201 McKinney Circle, Frederick, MD 21704.

Permission requests: For information on how to obtain permission to reproduce content, please go to the Aspen Publishers website at *www.aspenpublishers.com/permissions.* **Purchasing reprints:** For customized article reprints, please contact *Wright's Reprints* at 1-877-652-5295 or go to the Wright's Reprints website at *www.wrightsreprints.com*.

For documents prepared by an adviser's inside or outside counsel, where the adviser is the client and the documents were not produced to the board or any other third party, the adviser should be able to assert a claim of privilege against the board and against the SLC, as the adviser controls the privilege.[7] The adviser may waive the privilege if the adviser shares the documents with an adverse party.

Although disclosure of a communication to *third parties* generally acts as a waiver of privilege, no case law suggests that storage of privileged documents with an affiliated third-party would sever any applicable privilege, provided the documents are kept confidential.[8] This is important to funds because a fund usually maintains documents with its adviser or affiliates of the adviser.

Whether the attorney-client privilege may be asserted to protect draft Securities and Exchange Commission (SEC) filings varies by jurisdiction. Case law from the US Court of Appeals for the First Circuit, which includes Massachusetts, suggests that draft public filings may not be privileged against any party.[9] Other jurisdictions, including Maryland, find privilege waived as to the entire draft document.[10] Other courts consider the privilege waived only to those portions of draft documents actually disclosed.[11] If there is a privilege as to the draft SEC filings, the SEC's Standards of Professional Conduct for Attorneys suggests that the privilege can only be asserted by the board, rather than the adviser, since the filings are those of the fund.[12]

Section 4 of the SEC's Enforcement Manual directs the SEC Staff that it "should not ask a party to waive the attorney-client or work product privileges and is directed not to do so."[13] The Enforcement Manual states that "[t]he Enforcement Division's central concern is whether the party has disclosed all relevant facts within the party's knowledge that are responsive to the [S]taff's information requests, and not whether a party has elected to assert or waive a privilege."[14] The SEC will often take a party's cooperation into account in resolving an investigation or determining what sanctions, if any, should apply. The withholding of information on the basis of legal privilege may affect the SEC's judgment as to the extent of cooperation afforded.

Finally, the following are practical considerations for independent directors concerning the attorney-client privilege:

1. All parties should structure meetings and communications in a manner that is designed to maximize protection. For example, at a meeting with an attorney at which legal advice is requested and provided, persons who do not have a need to participate in the meeting ordinarily should not be present. This will prevent subsequent claims that the communication was not intended to be privileged or that the privilege was waived.
2. Minutes of meetings may lose their privileged status. For example, if an attorney notifies an adviser of a material compliance violation involving a fund, the adviser or the chief compliance officer will have an obligation to disclose that violation to the fund's directors. The disclosure of the minutes to an adverse party, such as the SEC Staff during the course of a Staff investigation, may result in the waiver of privilege.
3. Because notes taken during a meeting may be discoverable, consider whether taking notes or retaining the notes is appropriate.
4. When appropriate, limit minutes of meetings held in executive session to topical descriptions.
5. Communications should be kept confidential. To satisfy one of the four basic elements required to establish the existence of the attorney-client privilege, clients should make reasonable attempts to keep communications confidential.
6. Independent directors should consider asking *their counsel* to retain independent experts to conduct investigations requested by the directors, and request that the reports be delivered to such counsel. Doing so may protect the reports themselves as confidential attorney work product if undertaken in contemplation of possible litigation, while the communication by counsel of the results of the investigation would remain privileged.

The Common Interest Doctrine and the Attorney-Client Privilege

The common interest doctrine, also known as the joint defense privilege, is a rule of evidence that permits parties to share privileged information without a waiver of confidentiality protections where they have common interests in defending against a pending or anticipated proceeding.[15] The doctrine is an exception to the rule that no attorney-client privilege attaches to communications between a client and an attorney in the presence of a third person.[16]

The recognition of, and the test for, the joint-defense privilege, as with all testimonial privileges, varies by jurisdiction. Under the most commonly accepted interpretation of the joint-defense privilege, in order for the privilege to apply, the party asserting the privilege must show that: (1) the communication was made in the course of a joint defense effort;[17] (2) the statements were designed to further the effort; and (3) the privilege has not been waived.[18]

In general, communications between a fund's directors and the fund's adviser where there is a common interest/joint defense, should be deemed to be privileged against third parties. In order for two clients to have a common interest in a matter, their interests *arguably* need not be identical.[19] However, the requisite nature of the interest varies by jurisdiction. Certain jurisdictions require that the nature of the interest be "identical, not similar, and be legal, not solely commercial."[20] Other jurisdictions have a less strict approach and require that the interests be similar, not identical.[21]

When the attorney-client privilege applies in a common-interest scenario, the privilege cannot be waived without the consent of all the parties, and the voluntary disclosure by one party does not waive the privilege with respect to other parties.[22] If the parties sharing a common interest are subsequently engaged in litigation against one another, the privilege may no longer apply.[23]

Not all communications between a fund's directors and the adviser will be subject to protection under the common interest doctrine. Where the interests of the fund and those of the adviser diverge, such as with respect to adviser fees, communications involving their respective counsel likely will not be privileged.

Where applicable, independent directors should consult counsel regarding the advisability of entering into a joint defense agreement. While a joint defense agreement is not required to assert the privilege, an agreement may be evidence of the existence of confidential communications protected by the attorney-client privilege.[24] More generally, independent directors should consult counsel to understand fully the requirements for asserting the common interest doctrine in the relevant jurisdiction.

Insurance and Indemnification

Insurance

Funds normally purchase directors' and officers' liability insurance policies (commonly called D&O policies), which indemnify their directors and officers for claims made *against them* for their designated acts, errors or omissions. Funds also normally purchase "errors and omissions" insurance (commonly called E&O policies), which typically covers the fund for claims made *against the fund* for designated acts, errors or omissions by the fund or its representatives (for example, its directors and officers). Both forms of insurance protect against losses resulting from claims made against an insured for a wrongful act, including any actual or alleged error, misstatement, misleading statement, act, omission, neglect or breach of duty.

With their adviser and its affiliates, funds frequently acquire D&O polices and E&O policies on a joint basis due to the cost savings derived (greater coverage and/or savings on premiums).[25] A joint policy, however, also gives rise to the risk that one or more insured parties will exhaust the coverage of the insurance. This risk exists because joint D&O/E&O policies provide for an "aggregate" amount of coverage, and each payment on the policy therefore reduces the amount available for other joint-insureds. Ordinarily, this is more of a concern for directors because claims against the adviser and/or the fund are more likely to exhaust the relevant coverage limits.

Boards can mitigate the problem of reaching the policy maximum by entering into an agreement with the other insured parties that allocates coverage if the maximum is reached. For example, the allocation agreement could provide for a minimum coverage for each insured and, thereafter, the independent directors and the funds shall be indemnified fully before the adviser or its affiliates are permitted to recover any additional amount. Some D&O policies have separate or additional coverage for independent directors that will be available even if other coverage is not available due to exhaustion or exclusions.

Generally, the scope of coverage is a matter of negotiation and, of course, the premiums to be charged. Common issues for negotiation include, but are not limited to, exclusions from coverage, the definition of "claim" and the definition of "loss."

D&O policies and E&O policies contain certain exclusions from coverage.[26] D&O policies and E&O policies typically contain an exclusion for improper profit or fraudulent or dishonest conduct. Importantly for directors, pursuant to Rule 17d-1(d)(7) under the Investment Company Act of 1940 (ICA), joint D&O/E&O polices may "not exclude coverage for *bona fide* claims made against any director who is not an interested person of the investment company, or against the investment company if it is a co-defendant in the claim with the disinterested director, by another person insured under the joint liability insurance policy."

A threshold issue in determining coverage is what constitutes a covered "claim." Some D&O policies define claim broadly to include formal lawsuits and administrative proceedings, as well as investigations. Under these policies, insurers may request that an insured person demonstrate that it is the target of an investigation and has not merely received a general request for information. On the other hand, some D&O policies define claim to mean a written demand seeking monetary damages, which insurers interpret not to include investigations, or place dollar limits on claims for investigation costs.

While D&O policies typically cover "loss" resulting from certain claims against an insured, the definition of loss varies by policy. A D&O policy may exclude fines or penalties from the definition of loss. In addition, D&O policies ordinarily have retention provisions (similar to a deductible), limiting the coverage to amounts above a certain amount that the insureds must pay first.

D&O policies are generally "claims-made" policies, meaning that claims must be made during the policy period unless, and to the extent, an "extended reporting period" applies. An insured may pay an additional premium for the extended reporting period, which generally allows the insured to extend the policy period for some period of time. However, the act for which the insured person seeks coverage must have taken place during the original policy period.

D&O policies ordinarily state that an insured person shall not admit liability, consent to any judgment, agree to any settlement or make any settlement offer without the insurer's written consent. Because certain D&O policies are not clear as to whether the insurer is required to advance attorneys' fees and costs, litigation and disputes have arisen regarding the requirement to advance the fees and expenses.[27] D&O policies may require the insured person to obtain the insurer's consent prior to incurring "defense costs," the definition of which will vary by policy. On the other hand, D&O policies may limit defense costs to "reasonable" defense costs and require the cooperation, but not consent, of the parties. D&O policies generally provide that the insurer may not unreasonably withhold consent.

A D&O policy may not afford coverage to all persons associated with a mutual fund complex. Coverage disputes may arise as to how to allocate defense costs, settlements or judgments among the parties. D&O policies typically require that the parties agree to use their best efforts to determine a fair and proper allocation of all amounts to be allocated.

Indemnification

Depending on applicable state law and the fund's governing documents, indemnification may allow directors to be reimbursed from fund assets[28] for liabilities (including legal expenses) incurred by them as defendants and witnesses in fund-related civil litigation. As with D&O insurance, indemnification typically allows directors to receive advances to cover their legal and associated expenses.

Under state indemnification statutes, funds are typically *required* to indemnify directors in certain circumstances, and are *permitted* to indemnify fund directors in other circumstances. While there are variations by state, state laws commonly provide, for a director who has been fully exonerated, mandatory indemnification of the director for legal fees and expenses the director incurred.[29] State law also commonly permits, but does not require, a corporation or business trust to include provisions in its organic documents of organization, which provide for director indemnification of defense costs and of amounts paid in judgment or settlement, provided the director acted in good faith. State law may provide one or more procedures for a fund to make a determination regarding whether director indemnity is proper. On the other hand, state law commonly does not permit a director to be indemnified for costs arising from conduct that involves bad faith, willful malfeasance, or reckless disregard of duty or that resulted from active or deliberate dishonesty or improper personal benefit or, in a criminal proceeding, when the director knew or had reasonable basis to know that his conduct was unlawful.[30]

Provisions in fund governing documents typically grant directors the broadest indemnification rights available under applicable law.[31] Directors' indemnification rights are constrained by, among other things, the securities laws and SEC Staff interpretations. Section 17(h) of the ICA prohibits indemnification of a fund director where the director engaged in disabling conduct, which includes willful malfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of office.[32] Courts and the SEC have also generally taken the position that indemnification against liabilities under the Securities Act of 1933 is contrary to public policy and, therefore, unenforceable.[33] In addition, the SEC has placed limits on the circumstances under which a fund may advance an officer or director's defense costs.[34] Section 17(i) of the ICA similarly prohibits indemnification of a fund *adviser* where the adviser engaged in disabling conduct, which includes willful malfeasance, bad faith, gross negligence or reckless disregard of the adviser's duties under a fund advisory contract.[35]

Payment of Settlement Costs

Due to a number of factors, such as the cost of litigation or the desire to avoid a protracted legal battle, the majority of fund lawsuits that are not dismissed are resolved by a settlement. Generally, when a settlement is reached, it will be submitted for approval to the court in which the lawsuit is pending. Any settlement or compromise in a class action[36] or shareholder derivative action settlement[37] requires court approval.

Procedures for a proposed settlement, voluntary dismissal or compromise in a class action include the following: (i) the court must direct notice in a reasonable manner to all class members who would be bound by the proposal; (ii) if the proposal would bind class members, as is ordinarily the case, the court may approve it only after a hearing and on finding that it is fair, reasonable and adequate; (iii) the parties seeking approval must file a statement identifying any agreement made in connection with the proposal; (iv) if the class action was previously certified, the court may refuse to approve a settlement unless it affords a new opportunity to request exclusion to individual class members who had an earlier opportunity to request exclusion but did not do so; and (v) any class member may object to the proposal if it requires court approval, the objection may be withdrawn only with the court's approval.[38] Notice of the settlement, voluntary dismissal or compromise in a shareholder derivative action "must be given to shareholders or members in the manner that the court orders."[39]

Some, if not all, of a director's costs associated with a settlement will typically be covered by insurance and/or indemnification. The extent of coverage will vary based on a number of factors, such as the director's actions, the facts of the specific situation or the provisions of the relevant D&O policy. Because D&O policies typically require the consent of the insurance provider prior to entering into a settlement, it is important to communicate all details of and issues related to a settlement with the insurance provider. In addition, because insurance policies may exclude coverage for fines and penalties, an insured person will want to consider carefully how to structure any settlement to ensure that any monetary payments fall within the D&O policy's definition of loss.

If insurance coverage is exhausted or unavailable, the SEC's guidance is to the effect that any arrangement providing for the sharing of settlement costs, including litigation expenses, between a fund and an affiliate constitutes a joint transaction within the meaning of Rule 17d-1 under the ICA. Thus, in various no-action letter requests, the SEC Staff declined to provide relief to permit funds to share settlement and litigation expenses with an affiliate and indicated that the applicants must obtain exemptive relief.[40] Accordingly, funds and their affiliates have obtained such exemptive relief.[41]

With respect to regulatory actions, certain additional considerations regarding settlements are relevant. Importantly, the SEC will not enter into any settlement involving a fine or penalty in which the fine or penalty is paid by insurance or other form of indemnity. Typically, in regulatory actions, if the court approves the settlement, it issues a consent or decree, which is "to be construed for enforcement purposes basically as a contract."[42]

Conclusion

Beginning in 2003, the industry saw the beginning of several highly publicized regulatory investigations concerning market timing and improper revenue sharing arrangements. Scores of lawsuits were instigated against advisers, distributors, funds, and, in some cases, a fund's independent directors. While independent directors were named defendants in prior lawsuits, the scope of litigation that followed 2003 was without precedent in terms of the number of lawsuits and the number of those suits naming directors as defendants. Both parts of this article describe what funds' independent directors should know about fund litigation and how that litigation can affect them.

Notes

1. Black's Law Dictionary 1215 (7th ed. 1999). The attorney-client privilege is not synonymous with the work product doctrine. The work product doctrine precludes adversaries from discovering the "work product" of lawyers or non-lawyers (whether or not disclosed to the client) developed in anticipation of litigation. Attorney notes, research and compilations of background materials may qualify as protected work product. Similarly, memoranda, investigative reports, witness statements, and materials prepared by non-legal personnel such as investigators for attorney use in anticipation of, or preparation for, litigation are also protected. Although the work product doctrine is distinct from attorney-client privilege, a document may qualify for protection under both doctrines, *e.g.,* a document discussing trial strategies written by an attorney and communicated to his or her client. Unlike the attorney-client privilege, the work product doctrine provides only a "qualified" protection—it can be overcome by showing that the adversary needs the information and cannot obtain it in another way.

2. The public policy underlying the privilege is the promotion of obedience to the law, which is thought to be furthered by encouraging open and full communication between clients and their attorneys.

3. *See, e.g*., Restatement of the Law Governing Lawyers § 118 (Tentative Draft No. 1, 1988).

4. Under Delaware law, for example, a corporation cannot assert privilege to deny a director access to legal advice furnished to the board during that director's tenure. Moore Bus. Forms, Inc. v. Cordant Holdings Corp., Civ. A. Nos. 13911, 14595, 1996 WL 307444, at * 4 (Del. Ch. June 4, 1996). A director's ability to obtain privileged information from a company in this context has been interpreted as implicitly meaning that other directors cannot prevent a director from obtaining this information.

5. In re BCE West LLP, No. M-8-85, 2000 WL 1239117, at *2 (S.D.N.Y. 2000).

6. *See, e.g*., SEC v. Roberts, 254 F.R.D. 371 (N.D. Cal. 2008) (finding a waiver of privilege based, in part, on disclosure to a company board).

7. *See, e.g.,* In re Atlantic Financial Mgmt., 121 F.R.D. 141, 145 (D.Mass. 1988) (holding that attorney-client privilege applies where the client, as the asserted holder of the privilege, makes communications to an attorney for the purpose of seeking legal advice and where the privilege has not previously been waived).

8. *See, e.g*., In re Horowitz, 482 F.2d 72 (2d Cir. 1973) (finding that the privilege was waived as to documents held by the party's accountant, not because the accountant stored those documents, but because no efforts were made to maintain confidentiality). The unique structure of the mutual fund industry further supports that privilege should not be waived merely because a fund stores documents with its adviser.

9. *See., e.g.,* Fidelity Intern. Currency Advisor A Fund, 2008 WL 4809032, at *8 (stating that "[w]hen information

is supplied to a lawyer with the intent that it be disclosed in a required filing, such as a tax return or securities filing, the information is not confidential and therefore not protected by the privilege").

10. *See, e.g.,* Neuberger Berman Real Estate Income Fund, Inc. v. Lola Brown Trust No.1B, 230 F.R.D. 398, 413 (D.Md. 2005).

11. *See, e.g*., Schenet v. Anderson, 678 F.Supp. 1280, 1283 (E.D.Mich. 1988) (holding that information was privileged to the extent not disclosed).

12. *SEC Final Rule: Implementation of Standards of Professional Conduct for Attorneys,* Rel. No. IC-25919 (Jan. 29, 2003) states:

> [A]n attorney employed by an investment adviser who prepares, or assists in preparing, materials for a registered investment company that the attorney has reason to believe will be submitted to or filed with the [SEC] by or on behalf of a registered investment company is appearing and practicing before the [SEC] under this definition.
>
> Although some commenters objected to this construction of the definition of "in the representation of an issuer," those commenters did not contest either the fact that such an attorney, though employed by the investment adviser rather than the investment company, is providing legal services for the investment company or the logical implication of that fact: that *the attorney employed by the investment adviser is accordingly representing the investment company before the [SEC]*.

13. SEC, Division of Enforcement, Enforcement Manual (2008), available at *http://www.sec.gov/divisions/enforce/enforcementmanual.pdf*.

14. *Id.*

15. Black's Law Dictionary 1216 (7th ed. 1999).

16. This exception applies to agents of the attorney, such as paralegals, investigators, secretaries and members of the office staff responsible for transmitting messages between the attorney and the client, and to outside experts engaged to assist the attorney in providing legal services to the client, such as accountants and interpreters. Additionally, this exception reaches retained experts, other than those hired to testify, when the expert assists the attorney by transmitting or interpreting client communications to the attorney or formulating opinions for the lawyer based on the client's communications. Jenkins v. Bartlett, 487 F.3d 482, 491 (7th Cir. 2007). *See, e.g.,* In re Federated Mutual Funds Excessive Fee Litig., Case No. 2:04cv352 (W.D. Pa., March 25, 2010) (retained expert's report protected).

17. Some courts have held that the communications need not be made in anticipation of litigation to fall within the common interest doctrine. *See, e.g.,* U.S. v. BDO Seidman, LLP, 492 F.3d 806, 816 (7th Cir. 2007).

18. Hanover Ins. Co. v. Rapo & Jepson Ins. Services, Inc., 449 Mass. 609, 619 (Mass. 2007).

19. Restatement (Third) of the Law Governing Lawyers § 76(1) comment e (2000) states that "[t]he interests of the separately represented clients need not be entirely congruent."

20. DuPlan Corp. v. Deering Milliken, Inc., 397 F.Supp. 1146, 1172 (D.S.C. 1974).

21. In re Mortgage & Realty Trust, 212 B.R. 649, 653 (Bankr. C.D.Cal. 1997).

22. U.S. v. BDO Seidman, LLP, 492 F.3d 806, 817 (7th Cir. 2007).

23. Garner v. Wolfinbarger, 430 F.2d 1093, 1103 (5th Cir. 1970).

24. Hanover Ins. Co. v. Rapo & Jepson Ins. Services, Inc.,449 Mass. 609, 618 (Mass. 2007).

25. Such joint policies do not give rise to "joint transaction" issues under Rule 17d-1 due to an exemption contained in Rule 17d-1(d)(7) that permits such joint policies. The exemption is available provided that the board of directors of the fund, including a majority of the independent directors determine at least annually that the funds' participation in the joint policy is in each participating fund's best interest and, further, that the allocation of the insurance premiums paid by each fund is fair and reasonable.

26. In general, an insurer bears the burden of proving that an exclusion bars coverage. *See, e.g.,* A. Thomas Morris and Julia Reynolds Johnson, "Insurance Coverage Issues Arising from Investigations of the Mutual Fund Industry," *The Investment Lawyer* Vol. 11, No. 4 (Apr. 2004).

27. David A. Sturms, 2003 ICI Investment Company Directors' Conference, The Basics of Indemnification and Insurance for Investment Company Directors—How do they work? What should I ask? (Oct. 16, 2003).

28. Indemnification amounts paid by a fund to its independent directors are a fund expense. Because D&O insurance compensates the fund for the indemnification it pays, D&O insurance serves to eliminate the immediate impact on fund assets of indemnifiable liabilities that may be incurred by independent directors. Instead, the impact on fund assets is absorbed over time through the fund's payment of premiums for D&O insurance.

29. Because state statutes, fund governing documents and D&O policies vary, directors should consult their counsel to understand their insurance and indemnification rights.

30. *See,* ICI Mutual Insurance Company, "Independent Director Litigation Risk," *The Investment Lawyer*, Vol. 14, No. 9 (Sept. 2007).

31. *Id.* If a fund does not provide full indemnification to its directors, independent directors may want to consider consulting their counsel regarding ways to enhance their indemnification (*e.g.,* amending governing documents). In addition, independent directors may wish to speak with their counsel or the fund complex regarding restructuring the D&O policy to extend insurance coverage.

32. In addition, the SEC requires that indemnification provisions set forth reasonable and fair means for determining whether indemnification shall be made. In the SEC Staff's view, "reasonable and fair means" include: (1) a final decision on the merits by a court or other body before whom the proceedings were brought that the person to be indemnified was not liable by reason of disabling conduct; or (2) in the absence of such a decision, a reasonable determination, based upon a review of the facts, that the indemnitee was not liable by reason of disabling conduct by (i) the vote of a majority of a quorum of directors who are neither interested persons of the fund nor parties to the proceedings; or (ii) an independent legal counsel in a written opinion. *See Interpretation: Matters Concerning Independent Directors of Investment Companies*, Rel. No. IC-24083 (Oct. 14, 1999).

33. *See, e.g.,* 17 C.F.R. §§ 228.510, 228.512(e), 230.484(b); Globus v. Law Research Serv., Inc., 418 F.2d 1276, 1288 (2d. Cir. 1969).

34. The SEC has taken the position that before advancing legal fees to a director or officer, a fund's board must do one of the following: (1) obtain assurances, such as by obtaining insurance or receiving collateral provided by the director, that the advance will be repaid if the director is found to have engaged in disabling conduct, or (2) have a reasonable belief that the director has not engaged in disabling conduct and ultimately will be entitled to indemnification. *See Interpretation: Matters Concerning Independent Directors of Investment Companies*, Rel. No. IC-24083 (Oct. 14, 1999).

35. Under the Investment Advisers Act of 1940 (IAA), the SEC Staff has taken a similar position. The Staff's no-action guidance regarding indemnification provisions in advisory contracts with funds (and other "sophisticated clients") is that such provisions, with disabling conduct limits like those within ICA § 17(i), are not *per se* deceitful under the IAA's anti-fraud provisions. *See* Heitman Capital Mgmt., LLC, SEC No-Action Letter (pub. avail. Feb. 12, 2007).

36. Fed. R. Civ. P. 23(e).

37. Fed. R. Civ. P. 23.1(c).

38. Fed. R. Civ. P. 23(e).

39. Fed. R. Civ. P. 23.1(c).

40. *See, e.g.,* The South Bay Corporation, SEC No-Action Letter (pub. avail. Dec. 4, 1974); Contran Corporation, SEC No-Action Letter (pub. avail. Jan. 23, 1975). *See also* National Student Marketing Corporation, SEC No-Action Letter (pub. avail. Aug. 19, 1973) (no-action request denied with respect to proposed litigation expense sharing between fund and affiliate as plaintiffs).

41. *See, e.g.,The Brazilian Equity Fund*, Rel. Nos. IC-26781 (March 9, 2005) (notice) and IC-26826 (March 31, 2005) (order).

42. U.S. v. ITT Continental Baking Co., 420 U.S. 223, 238 (1975). "What a court would have done is irrelevant in construing a settlement agreement." Meyer v. Oppenheimer Mgmt. Corp., 609 F.Supp. 380, 387 (S.D.N.Y. 1984).