

## Status of Independence Rule for Registered Investment Companies

*April 14, 2006*

On April 7, 2006, the U.S. Court of Appeals for the D.C. Circuit gave new, but uncertain life to the fund governance standards adopted by Securities and Exchange Commission (the "SEC") on July 27, 2004 requiring that (1) at least 75% of the directors of a registered investment company ("fund") are not "interested persons" of the fund; and (2) a disinterested director serve as chairman of the board of directors of the fund (the "Conditions"). The Court determined that the SEC technically violated the Administrative Procedure Act in its adoption of the rule and gave the SEC 90 days to correct the technical violation and file a status report with the Court.

As you may recall, last year the U.S. Chamber of Commerce challenged the SEC's fund governance rule. In that case, the Court held that the SEC had the authority to adopt the rule but had failed to determine the costs of imposing the Conditions and failed to address a proposed alternative to the independent chair Condition. The Court remanded the case to the SEC. The SEC responded within a matter of days after the Court's decision and one day before Chairman Donaldson's resignation. (Chairman Donaldson's vote was the swing vote with two commissioners in favor of and two commissioners opposed to the Conditions.) The SEC voted not to modify the Conditions and determined not to reopen the rulemaking record for further comment. The Chamber's appeal challenged the SEC's decision not to modify the Conditions.

The Court, on appeal, determined that the SEC did not meet its procedural burdens upon remand because it did not reopen the record for public comment on the costs of implementing the Conditions. The Court noted, however, that because many funds have voluntarily adopted the challenged Conditions, immediate vacation of the Conditions risks substantial disruption to the mutual fund industry. Accordingly, the Court decided to withhold imposing its mandate and give the SEC the opportunity to reopen the record for comment on the costs of implementing the Conditions.

In commenting on the Court decision, Chairman Cox did not reveal the SEC's next move but noted that the SEC would comply with the Court's ruling and come up with a result that protects the interests of funds and their shareholders. Some industry observers believe the SEC will try to push through the adoption of the 75% independence Condition but eliminate the independent chair Condition.

If you have any questions about the Court decision or would like to have a copy of the decision, please contact Sarah E. Cogan ([scogan@stblaw.com](mailto:scogan@stblaw.com)), Cynthia G. Cobden ([ccobden@stblaw.com](mailto:ccobden@stblaw.com)), Brynn D. Peltz ([bpeltz@stblaw.com](mailto:bpeltz@stblaw.com)) or David E. Wohl ([dwohl@stblaw.com](mailto:dwohl@stblaw.com)) of our firm at (212)-455-2000.