OFFICIAL TRANSCRIPT
PROCEEDINGS BEFORE

THE SUPREME COURT OF THE UNITED STATES

DKT/CASE NO. 82-1200

TITLE DAILY INCOME FUND, INC., AND REICH & TANG, INC., Petitioners v. MARTIN FOX

PLACE Washington, D. C.

DATE November 7, 1983

PAGES 1 thru 38

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IN THE SUPREME COURT OF THE UNITED STATES

DAILY INCOME FUND, INC. AND REICH & TANG, INC.,

Petitioners

v. No. 82-1200

MARTIN FOX

Washington, D.C.

November 7, 1983

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 10:49 a.m.

APPEARANCES:

DANIEL A. POLLACK, ESQ., New York, New York; on behalf of the Petitioners.

RICHARD M. MEYER, ESQ., New York, New York, on behalf of the Respondent.

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C O N T E N T S

PROCEEDINGS

CHIEF JUSTICE BURGER: Mr. Pollack, I think you may proceed whenever you are ready.

ORAL ARGUMENT OF DANIEL A. POLLACK, ESQ.

ON BEHALF OF THE PETITIONERS

MR. POLLACK: Mr. Chief Justice, and may it please the Court:

The question presented in this case is whether a shareholder's action under Section 36(b) of the Investment Company Act is exempt from the director demand requirement of Rule 23.1 of the Federal Rules of Civil Procedure.

Underlying this seemingly narrow question are several questions of perhaps more profound dimension, some or all of which this Court may wish to consider.

First, what exactly is a derivative action or, stated another way, what are the necessary and sufficient conditions for a derivative action?

Second, what is the purpose of the director demand requirement?

Third, does an investment company have an implied right of action under Section 36(b)?

Petitioners' position in this case is that the director demand requirement does apply to a shareholder's action under Section 36(b) because the action

is derivative; that the director demand requirement performs a most valuable function of permitting pre-litigation resolution or adjustment of disputes, thus avoiding needless litigation; and that the director demand requirement is consistent with two long-standing and salutary policies repeatedly upheld by this Court. First, the exhaustion of intracorporate remedies, and, second, letting directors direct.

The facts in this case may be simply summarized, and they are in our blue brief.

The Daily Income Fund is a money market fund. Reich & Tang are the investment advisors to Daily Income Fund. A majority of the directors of Daily Income Fund are disinterested directors; that is they are in no way affiliated with or associated with the advisor.

In 1981, Martin Fox, a minority shareholder of the Daily Income Fund, instituted an action against Reich & Tang allegedly to recover excessive fees. In doing so, he simply ignored the directors and by-passed entirely the board.

Judge Kevin T. Duffy in the Southern District of New York dismissed his complaint for failure to comply with the director demand requirement of Rule 23.1.

The Court of Appeals reversed and held that

no compliance was required, because the action was not, in the words of the Court of Appeals, "strictly speaking derivative."

The Court of Appeals reached this conclusion because it said that the investment company itself had no right of action under Section 36(b).

The Court of Appeals also went on to hold in a supplementary holding that demand on the directors would be, in its words, "an empty, unfruitful, and dilatory exercise."

The starting point of the legal analysis seems not to be in dispute. Rule 23.1 applies to and governs all derivative actions in the federal courts.

QUESTION: Mr. Pollack, where in your brief will we find the full text of 23.1?

MR. POLLACK: Your Honor, the full text is not in our brief.

QUESTION: It is not in your brief even though that is the controlling --

MR. POLLACK: That is correct, Your Honor. I think it was an oversight on our part. We did print it in the Second Circuit brief as an addendum. Unfortunately, we did not print it in the Supreme Court brief.

QUESTION: How about your petition?

MR. POLLACK: I don't believe it is printed in the petition either.

QUESTION: Yes, page 19a of the petition, Footnote Six.

QUESTION: You didn't really --

QUESTION: It is in the Court of Appeals' opinion.

There is no literal non-compliance with the rule, is there?

MR. POLLACK: I believe there is, Justice Stevens.

QUESTION: The rule merely requires "that the complaint shall allege with particularity to efforts, if any, made by the Plaintiff to obtain the action he desires of the director." He didn't make any efforts, did he?

MR. POLLACK: Correct. And, the failure to do so has repeatedly been held by courts for many, many years to be a basis for dismissing such an action.

QUESTION: But, is that a matter of federal law or state law?

MR. POLLACK: I believe that is a matter of federal law.

QUESTION: Well, at least literally Rule 23 does not require a demand. It merely requires a

description of whatever demand was made.

MR. POLLACK: Your Honor, that position was taken in the SEC brief.

QUESTION: Well, I am just saying that is a fact.

MR. POLLACK: Well, we state in response to that, Your Honor, that the courts have repeatedly held that it is more than a mere pleading requirement, that there is a substantive requirement of demand intended by that rule.

QUESTION: Do you suggest as a matter of state law -- Say the State of New York might provide that there is no such requirement, it is an in New York corporation to be a valid state law?

MR. POLLACK: I think that would be --

QUESTION: Could the State of New York do that if it wanted to?

MR. POLLACK: I think an action in the federal court that would conflict with the policy of Rule 23.1.

QUESTION: You think the State of New York would not have the power to do that in view of the way Rule 23 has been construed?

MR. POLLACK: That is my belief, Your Honor.

If the starting point is that Rule 23.1 does apply to and govern all derivative actions in the federal

courts, the initial question becomes is a shareholder's action under Section 36(b) derivative?

This Court has said that it is derivative and Congress has said that it is derivative.

In the landmark case of Burks against Lasker decided by this Court four years ago, Mr. Justice Brennan, writing for the unanimous Court, stated as a general proposition a derivative suit is brought by shareholders to enforce a claim on behalf of a corporation.

QUESTION: Mr. Pollack, we are not talking about the meaning of the word "derivative," we are talking about the meaning of the word "derivative" as it is used in 23.1, right?

MR. POLLACK: Yes, Your Honor.

More specifically and more importantly for present purposes, Mr. Justice Brennan went on specifically to refer to a suit under this very section, Section 36(b), as a derivative suit at page 484 of 441 U.S. Mr. Justice Brennan stated for the unanimous Court, and when Congress did intend to prevent board action from cutting off derivative suits it said so expressly.

Section 36(b) added to the Act in 1970, performs precisely this function for derivative suits charging breach of fiduciary duty with respect to advisor fees.

That seems to me to be an unequivocal and unambiguous recognition by this Court of the derivative nature of the shareholder's action under Section 36(b).

Congress, as I said a moment ago, has also characterized such actions as derivative.

In the 1970 House Report, which is cited in our briefs, it is stated at page 78, "Section 19 of H.R. 14737 would add a requirement that derivative suits under Section 36(b) of the Act as amended be brought by shareholders acting in good faith and with justifiable cause."

QUESTION: Well, Mr. Pollack, is it an essential ingredient of being a derivative action that the corporation could have brought suit on its own behalf?

MR. POLLACK: The Court of Appeals held that it was an essential ingredient. We have argued in our brief that it is not, because one possible construction of Rule 23.1 is that the corporation have a right -- If, for example, the corporation has a state court right, we would argue that that is a right or a right in this case not to be charged excessive fees which complies with the literal language of Rule 23.1.

QUESTION: So you adhere to the view that you took in your brief, I take it, that in order for an action to be a "derivative" action within the meaning

of Rule 23.1 one need not show that the corporation could have sued on its own behalf?

MR. POLLACK: We take that a back-up position. We believe in this case that we have demonstrated and can demonstrate to this Court that the corporation could sue on its own behalf under Section 36(b).

One other cite to the legislative history on the characterization of a 36(b) action as derivative will be found at page 83 of that same 1970 House Report.

The Court of Appeals --

QUESTION: You have been doing a lot of cross referencing between legislative history, opinions of this Court, language of the rule. How would you define the term "derivative" as it is used in the rule?

MR. POLLACK: I believe that Justice Brennan's definition in the Burks case is a satisfactory definition; that is to say an action brought on behalf of a corporation by a shareholder.

QUESTION: You were in that case I take it?

MR. POLLACK: Yes, Your Honor, I did argue before this Court in that case.

QUESTION: Did you win?

MR. POLLACK: Yes, Your Honor.

(Laughter)

MR. POLLACK: That is why I called it landmark,

Your Honor.

QUESTION: That messes with your averages, you know.

(Laughter)

MR. POLLACK: I pondered that long and hard when the writ of certiorari was granted in this case, Your Honor.

The Court of Appeals, ignoring the evidence of the derivative nature of a Section 36(b) action which I have just cited to the Court, that is Justice Brennan's statement in Burks and the House Report references to an action as derivative, determined that this was not a derivative action because the company itself has no right of action under Section 36(b).

To unravel that error, one must look into the question of whether an investment company has an implied right of action under Section 36(b). To do so we look --

QUESTION: Doesn't 36(b) provide in so many words who may bring an action under it?

MR. POLLACK: Yes, Your Honor.

QUESTION: Why do you ever get to an implied question then? If Congress just states generally that a suit may be brought, without saying who may bring it, you probably have room for implied analysis under

Cort against Ash. But, when Congress says this is the kind of action that can be brought and it may be brought by an (a), a (b), or a (c), isn't that pretty well the ball game? How would you ever imply that also a (d) could bring it?

MR. POLLACK: We believe that the recent cases of this Court, and I think it is Cannon -- I may have juggled them in my mind -- While I am standing here, I will look before I rebut -- stands for the proposition that the fundamental purpose of the section must be considered. And, in this case, the fundamental purpose of Section 36(b), which was enacted in 1970, was to strengthen the hand and role of the independent directors.

Looking first at the language to determine whether there is an implied right, the section itself says, in pertinent part, that a shareholder may sue "on behalf of" the investment company. We believe that that is clearly suggestive of a derivative concept.

Turning to the legislative history, unfortunately, as in many statutes, the legislative history appears to be silent on the issue of an implied right as regards the investment company itself.

Therefore, one must look in the terms of the Merrill Lynch and Curran analysis to the state

of the law at the time Congress passed this section in 1970.

And, the state-of-the-law was that there was universal recognition of the derivative character of a lawsuit to recovery excessive fees from an investment advisor.

We have cited those cases at commonlaw and also under Section 36 which preceded 36(b) at page 10 of our blue brief.

It follows necessarily that if those suits were derivative prior to the enactment of this section, that they were derived from a primary right in the investment company itself.

Congress is, of course, under the current doctrine, presumed to know the state-of-the-law at the time it enacted Section 36(b) and since there is no evidence whatsoever of congressional intent to deny or eliminate that right in the investment company, we believe that the presumption should be applied that Congress must have intended to preserve that right. To do so is consistent with the overall intent of the 1970 amendments as I mentioned a moment ago. That overall intent was in part to strengthen the role of the disinterested directors. And, it makes good sense to imply a right in this situation because the fact

that a shareholder was granted a remedy to sue for excessive fees should not mean that the same remedy is not available to the investment company itself.

As we argue in the first page of our reply brief, the yellow-covered brief, there is something most anamolous about saying that an investment company, if a new group of directors comes aboard, has no right to sue its investment advisor if the directors feel that there has been an overcharging merely because a shareholder does not happen to raise the matter.

I find that a result that is almost unthinkable in terms of interpreteing a sensible intent on the part of Congress.

The Courts of Appeals went on in a supplementary holding to hold that the application of the director demand rule is inconsistent with the operation of Section 36(b). We believe this too is erroneous.

The fact that the directors may perhaps not be able to terminate a Section 36(b) action, a doctrine that is much talked about in the industry as a result of Mr. Justice Brennan's dictum in Burks does not --

QUESTION: You didn't refer to Justice Brennan's earlier statement in his opinion, the opinion for the Court, as dicta. I take it what comes out right of the opinion and what comes out bad is dicta.

(Laughter)

MR. POLLACK: No. That is a fair criticism. We can well live with this, be it holding or dictum, because the fact is that the termination doctrine does not obviate the benefit of the demand rule. The termination -- The mere fact that directors may or may not be able to terminate a Section 36(b) action does not render nugatory the value of having a demand rule here and that value is to prevent, before there is litigation, unnecessary litigation, to let the directors rethink the question as to whether there has been an overcharge, to let the directors convince the shareholder that perhaps he is wrong. It goes both ways.

But, in any event, we believe that it is a salutary rule.

QUESTION: Well, couldn't the director start to rethink as soon as the complaint is served?

MR. POLLACK: Yes, but there is the Damoclesian sword of the complaint hanging over their head and we believe the purpose of the demand rule is to provide for pre-litigation considerations, Mr. Chief Justice.

QUESTION: Just as the statute of limitations is always looming in the background. There is a limit on the time that they can do their rethinking, isn't it?

MR. POLLACK: Yes, Your Honor, and that is, in our judgment, the second error of the Court of Appeals in this supplementary holding.

The statute of limitations, this one-year statute provided by Section 36(b)(2) is not shortened, it is simply advanced. To give a simple example, if on January 1 of a given year a shareholder makes a demand and the demand is responded to and the demand is rejected, on March 1 he institutes litigation. He may recover the period March 1 to March 1 instead of January 1 to January 1. There is no saying which period of is better, but, in any event, there is no shortening of the period by this pre-litigation demand. It is simply an advancing of the period.

At this point I will be seated and await my rebuttal.

Thank you, Mr. Chief Justice.

CHIEF JUSTICE BURGER: Very well. Mr. Meyer?

ORAL ARGUMENT OF RICHARD M. MEYER, ESQ.

ON BEHALF OF THE RESPONDENT

MR. MEYER: Mr. Chief Justice, and may it please the Court:

I would like to choose a somewhat different starting point for analyzing this case than that chosen by my adversary.

I believe the starting point must be an analysis of the statute, and as this Court has so frequently said, the starting point for analyzing a statute is the wording of the statute itself.

Section 36(b), which was enacted after years of consideration and study by the Congress, expressly provides for an action to be brought by any security holder of an investment company or by the Securities and Exchange Commission.

No mention is made in the statute of a right on behalf of the investment company itself.

Indeed, in the course of the legislative history --

QUESTION: May I just stop you there? I don't think you are reading the statute accurate. It says in words it may be brought on behalf of such company.

MR. MEYER: The words, on behalf of such company, do not, I suggest, imply that that means that the company itself may bring the statute nor does it make it derivative.

For example, the Securities and Exchange Commission --

QUESTION: Well, that may be, but those words are in the statute.

MR. MEYER: The words, "on behalf of the investment company" are in the statute.

QUESTION: Wouldn't the suit be pressing a company right?

MR. MEYER: No, Your Honor, I submit not.

QUESTION: Who would the recovery --

MR. MEYER: The recovery would go to the company, but that does not make it a right --

QUESTION: You mean it is getting something for nothing that it doesn't have a right to?

MR. MEYER: It --

QUESTION: It certainly has a right to the recovery if there is one.

MR. MEYER: It has a right to recovery, that is correct, but --

QUESTION: So the suit is pressing something on behalf of the company.

MR. MEYER: The suit seeks recovery on behalf of the company. That does not necessarily mean, and I suggest in the context not only of the statute but of the legislative history, it does not mean that the company is the one to assert that right in the federal court or any other court.

QUESTION: Maybe not, but if the company has a right, they may not be able to sue for it, but

if it has a right against the advisor and the shareholder may assert that right on behalf of the company, certainly it is fairly reasonable to say that a suit by the stockholder is one on behalf of the company.

MR. MEYER: The statute indeed says that the suit is on behalf of the company.

QUESTION: Yes. And, you could certainly argue that it is a derivative of the company right. It depends upon the company's right.

MR. MEYER: Well, the statute also says that the suit that may be brought by the Securities and Exchange Commission is on behalf of the company. The recovery will go to the company. I don't think that anyone would seriously argue that the Securities and Exchange Commission in enforcing the public policy of the United States as enunciated in this statute would be obliged to make a demand upon the directors of the company before it were permitted to proceed with an action to vindicate the public interest.

And, I suggest --

QUESTION: Mr. Meyer, may I interrupt again? I don't think the statute says the words "on behalf of" don't apply to the action by the Commission. There is a comma after Commission and then you have the whole phrase, whereby a security holder and so forth on behalf

of the company, then a comma. I don't think the "on behalf of" language applies to the Commission action.

MR. MEYER: Well, the fact of the matter is that there has been, to my knowledge, one action brought by the Securities and Exchange Commission pursuant to the statute in which the Commission did recover and the recovery went to the investment company.

QUESTION: I see.

MR. MEYER: And, I can't visualize any other type of result. It certainly wouldn't go into the United States Treasury.

I think, in looking at the legislative history, that Mr. Pollack stated that the principal purpose of Section 36(b) was to strengthen the role of the independent directors. I believe that is not at all the case.

The legislative history contains repeated references to the inadequacy of the independent directors. It contains repeated references to the desire of Congress to entrust the enforcement of rights against investment advisors to security holders, not just shareholders, but all security holders, and to the Securities and Exchange Commission.

The legislative history is replete with references to the fact that advisory fees by investment advisors

to mutual funds and other investment companies had been excessive.

The legislative history repeatedly asserts that not only have the directives been ineffective in reducing these fees, but also the so-called disclosure requirements under the Act have been ineffective and the asserted competition which the investment company institute maintained was effective was indeed no effective in reducing advisory fees under the Act.

Now, what did Congress provide with respect to this rather important function that my adversary assigns to the strengthening of directives? It did essentially three things.

It broadened the definition of affiliated directors, changed the terminology to call them interested directors, and expanded the definition of who would be an interested director to include, for example, a member of the immediate family of someone on the investment advisor, to include someone who had a substantial financial relationship with the investment advisor such as counsel, general counsel to the investment advisor.

I submit that is hardly a major legislative move.

The other areas in which they acted to strengthen

the role of the independent directors consisted of a provision providing that in evaluating the advisory contract the affiliated directors must provide and the unaffiliated directors must receive such information as would be sufficient in order to pass upon the investment addvisory contract.

I submit that that is hardly an extension over the pre-existing law. The Second Circuit had held in -- I believe it was in 1961 in Brown versus Bullock that the approval of an advisory contract must not be merely formal but must evidence a substantive judgment on the part of the directors.

QUESTION: Mr. Meyer?

MR. MEYER: Yes.

QUESTION: What inference do you ultimately draw from your different view of the legislative history of the 1970 amendment?

MR. MEYER: The inference that I draw from my view of the legislative history of the 1970 amendment was that this was a concerted effort extending over a period of years beginning as early as 1958 when the Wharton study was commissioned by the SEC under the egis of Congress and continuing right up to 1970. There were intermediate reports by the SEC, a special study in 1963, the Public Policy Report in 1966, all

of which went to the proposition that there must be effective means for the federal courts to pass upon the propriety of advisory fee compensation in the investment company field and that those effective means were not being provided by the independent directors and could not in the nature of things be provided by the independent directors and that stockholder and SEC action was required to do that.

Let me add to that one important reason why this is so in the investment company field as distinguished from the corporate area generally.

Congress was faced with an existing situation where the vast majority of investment companies were managed not by their own internal staffs but by external investment advisors. They were extremely dependent upon these external investment advisors because these people had sponsored the fund, they sold shares of the fund, and there was no practical way for the directors, as independent as they might be, to negotiate meaningfully with them.

Congress decided, and they did have an alternative, they could have prohibited external investment advisors. They chose to stay with the existing system. But, in doing so, they said we must take effective means to ensure that this conflict of interest which is built

in by the very structure must have a check and balance and that check and balance is an action by the security holder and by the SEC which will be ultimately passed upon by the court.

Now, I would like to respond to a point raised in Petitioners' reply brief on page one. It was also a point that the First Circuit raised and that is that if a new board of directors comes in and decides to bring an action against an expelled investment advisory, it would be unthinkable that they would be powerless to do so under the statute. I would suggest there are three answers to that.

The first answer I have already gone into in some length and that is that what we are dealing with here is congressional intent. Never in all of the years preceding the enactment of the 1970 amendment nor in the years since has a board of directors of an investment company brought an action for excessive advisory fees against its investment advisor. This fact was called to Congress' attention during the legislative history. They could not possibly have conceived that this was a realistic possibility in enacting the statute and when the statute is interpreted it must be interpreted against the background of what Congress assumed to be, and rightfully so, the likely situation;

where directors of a mutual company are the very ones who have approved the contract that is in issue, and, therefore, it becomes a functionless act to demand them to bring suit against the advisor on a contract that they have already determined presumably to be fair and adequate.

If, however, there should be such a change in management and a change in heart that the directors of the investment company decide that something must be done about the old investment advisor who is no longer there, they still have two additional remedies.

Number one, they could request the SEC to bring an action. And, I would think that the -- It could not be lightly assumed that the SEC in the exercise of its statutory functions would be derelict if the directors did, in fact, have sufficient reason to make that type of request.

Finally, I think that in virtually every case, and certainly in the present case, the so-called non-interested directors are usually shareholders. In this case, they are all shareholders of the fund. So, they could bring an action as a shareholder, just as Mr. Fox brought the action in this case. They are not powerless. They can act through the means that we have suggested.

Finally, I would like to stress the point that although we claim that the investment company does not itself have a right of action, and, therefore, under Rule 23.1, which requires merely that an allegation be made concerning demand where a corporation has a right which it fails to assert.

In addition to that we also argue that even if the investment company does have a right of action that the intent of Congress and, indeed, the language of this Court in Burks against Lasker suggests that there need be no demand upon the directors to bring the action.

My adversary refers to the statement in Burks against Lasker as dictum. He refers to the statement as applying merely to a termination case. Now, the actual language which this Court used and while there were two separate concurring opinions, there were no dissents, so that the decision was unanimous. The language that this Court used was to the effect that when Congress decided to prevent directorial action from cutting off, and those are the words that are used, cutting off shareholder actions, it knew how to do so and it did so in Section 36(b).

And, by way of analogy, the Court cited in a footnote, Section 16(b) of the 1934 Act, stating

that this Act permits shareholder action notwithstanding the decision of the directors not to bring suit.

With respect to the suggestion that dispensing with a demand requirement would result in the bringing of unwarranted strike suits, this was an issue that was raised before Congress. Congress chose not to be swayed by that argument and, indeed, I think that the demand requirement really has little, if anything, to do with the so-called strike suit.

The demand requirement is over 100 years old. It can be traced back to Hawes versus Oakland.

The abuses arising out of shareholder litigation arose in the early part of this century and they were remedied or attempted to be remedied by the most part by providing for -- providing that no corporate action could be dismissed, no derivative action could be dismissed absent notice to shareholders and court approval. Those were the methods that were sought to be used to counter the so-called strike suits.

I submit that they have been extremely successful.

Finally, again, although I have said several finallies, but one further point with respect to this so-called distinction between termination and demand.

In the Third Circuit case, Weiss versus Temp

Fund, Judge Becker was trying to square the decision in that case with the earlier decision of the Third Circuit in Lewis versus Curtis in which the Third Circuit had held that the exact same standards that apply to termination apply to demand.

Judge Becker said that he agreed with Lewis versus Curtis insofar as it held that, but said Judge Becker, because this Court in Burks against Lasker applied a conclusive presumption to what he regarded as a termination situation and because the two situations were factual situations he would not apply an equally conclusive presumption to the demand question.

Now, I submit that given that the two situations involved, as logic compels that they are involved, namely -- The logic that I am referring to is that what we are really asking here is what is the function of the board of directors? It is to exercise a business judgment. If their business judgment is not to be given weight in a termination situation, then neither should it be given weight in a demand situation.

And, while Judge Becker attempted to make that distinction in the Weiss case, I suggest that it really doesn't carry very much water and should be rejected by this Court.

Thank you very much.

QUESTION: Mr. Meyer?

MR. MEYER: Yes.

QUESTION: You can add one more finally. You brought this complaint?

MR. MEYER: Yes, I did.

QUESTION: You filed this complaint. And, you named the Daily Income Fund?

MR. MEYER: That is correct.

QUESTION: Is that the money market fund?

MR. MEYER: That is the fund, yes, sir.

QUESTION: And, why did you name the Daily Income Fund.

MR. MEYER: I named the fund, and I may have made a mistake, but I named the fund because I read the statute as reading that the recovery would go to the fund and that the judgment, in order to be complete, ought to include the beneficiary of the judgment.

QUESTION: Well, doesn't the statute say you shouldn't maintain an action against anyone except the recipient of the payment?

MR. MEYER: Well, yes. The fund is a nominal defendant. It certainly -- We are not asking the fund to pay any money.

QUESTION: Well, you don't think -- Do you think the fund should be a Plaintiff or Defendant or

what? Could it be realigned as a Plaintiff or what?

MR. MEYER: This issue has arisen many times in derivative actions and in diversity actions as well. Just through sheer habit and the length of time in which these suits are brought, it is customary to name them, since they are not a willing Plaintiff, to name them as a Defendant, but I think that is purely a formal matter.

QUESTION: I take it in ordinary derivative actions the failure to, if there has been a failure, to go to the board to comply with, Rule 23 can be taken advantage of and asserted by a third party who sued?

MR. MEYER: That is quite correct and, in fact, I think that is another reason why it is apparent that no such requirement was intended by Congress in this case because by virtue of the statute virtually every investment company has a majority of unaffiliated directors and that would in effect nullify the statutory purpose behind Section 36(b), which was to, as I said before, give shareholders or security holders indeed and the SEC the right to challenge excessive advisory fees.

CHIEF JUSTICE BURGER: Do you have anything further, Mr. Pollack?

MR. POLLACK: Yes, Mr. Chief Justice.

ORAL ARGUMENT OF DANIEL A. POLLACK, ESQ.

ON BEHALF OF THE PETITIONERS

MR. POLLACK: Mr. Meyer would set at naught or ascribe little value to the independent directors of the mutual fund and suggests that Congress did so in the legislative history. We believe otherwise.

Footnote 15 at page 485 of 442 U.S. represents a summation of the legislative history by Justice Brennan in which he concludes with this observation: "Congress surely would not have entrusted such critical functions as approval of advisory contracts and selection of accountants to the statutorially disinterested directors had it shared the Court of Appeals' view that such directors could never be disinterested where their codirectors of investment advisors were concerned."

Similarly at pages 4900 and 4903 of the Senate Report, there is amply supporting reference to our position that a central purpose of these amendments of 1970 was to strengthen the disinterested directors.

Mr. Meyer seeks to simply treat them as if they are not there.

Secondly, Mr. Meyer suggests that if there is no right in the investment company the directors are not rendered powerless because they can go to the SEC and ask them to sue or they can bring an action

as shareholders themselves. Well, that is not consistent with the functions of directors. Directors are to direct. They need not go to the SEC under any state corporate law with which I am familiar and ask the SEC to do their work for them.

And, similarly there is no requirement that they be shareholders of the investment company in order to serve as directors. Therefore, I suggest that this second solution is inadequate.

QUESTION: Could I ask you, before Rule 23.1 comes into play, it assumes that the corporation or association has failed to enforce a right?

MR. POLLACK: Correct.

QUESTION: You say in this case the fund has failed to exercise a right.

MR. POLLACK: I don't suggest that at all. They were not given the opportunity to --

QUESTION: Yes, it says had it failed.

MR. POLLACK: There is a dispute, of course, between the parties as to whether they have failed and that is the very function of the demand rule, to enable a dialogue to go forward and for the directors to say --

QUESTION: Assuming we disagreed with you and assuming we thought that there was no right in

the firm to sue under Section 36, to sue the advisor under 36, that it just couldn't exercise any right under the statute to sue. Then what about Rule 23?

MR. POLLACK: We have argued as a back-up position in our brief that we are still within the language of Rule 23.1, because we have a right not to be charged excessive fees. It may not be a right under Section 36(b).

QUESTION: It may be you have a right, but you say -- but the rule says you have to fail to enforce it and so -- But, if you have no right to enforce the right, if you have no cause of action to enforce the right under the statute, what then, do you turn to state law?

MR. POLLACK: Yes.

QUESTION: Okay.

QUESTION: Mr. Pollack, may I ask one question about the second of your two responses to the point that the other remedies, that the directors might go to the SEC or they might be shareholders themselves.

MR. POLLACK: Yes, sir.

QUESTION: Isn't it also possible your response to the latter is they don't have to be shareholders and, of course, that is true, but would it not also be conceivable, if they thought they had a good case

and they were willing to finance it with corporate funds, that they could fine the shareholder and assure him that the corporation would pay the expenses of litigation even though the corporation couldn't litigate directly?

MR. POLLACK: I suppose that is a theoretical possibility, but if those directors were lawyers that would get them into quite a bit of hot water ethically.

QUESTION: Do you think that would be an ethical problem if they thought there was a clear violation and that the corporation would benefit from the action?

MR. POLLACK: I would not want to be a director-lawyer and be someone seeking a plaintiff to bring a lawsuit.

QUESTION: Say you had non-lawyer directors. All directors aren't lawyers.

MR. POLLACK: A harder case, I agree.

But, I don't think the corporate law of any state of which I am familiar envisions that the directors shall go out and find a shareholder to do their work for them. I think that the power resides in the directors to act for the corporation. Otherwise, they are obduring and abdicating.

QUESTION: Suppose the directors, Mr. Pollack, concluded shortly after the suit was brought that maybe

there was quite a bit to it. Is there any bar that you know of to having the directors go to the court with a motion to intervene on behalf of the corporation and be dismissed as defendants? I am talking about the prudential aspect. It perhaps is a novel motion, but any bar that you know for doing that?

MR. POLLACK: I think, Mr. Chief Justice, that that gets into the issue raised by Justice Brennan's statement about cutting off. The argument would be made if they can't cut it off, then they can't intervene for the purpose of cutting it off. And, I think there would be --

QUESTION: They aren't intervening to cut it off, they are intervening to assert the corporation's right along with the plaintiff, whether he is derivative or whatever.

MR. POLLACK: I suppose in theory that is possible that the directors could seek to intervene. Of course, that would -- on behalf of the corporation. I should think that that would necessarily imply, if they can do that, that they do have -- or that the investment company does have a right of action under Section 36(b) and that they are asserting it in litigation.

QUESTION: What would you have done if -- You represent the Fund, don't you?

MR. POLLACK: Correct, Your Honor.

QUESTION: If the Fund hadn't been named at all as a defendant, would you have been in this case?

MR. POLLACK: Yes.

QUESTION: What?

MR. POLLACK: Yes, because the --

QUESTION: What would you have done, intervened or --

MR. POLLACK: No. You say if Daily Income Fund had not been named as a defendant at all?

QUESTION: Yes.

MR. POLLACK: I suppose I would not be here today.

QUESTION: Well, you are here just representing what is called the nominal defendant and you are asserting that you really don't -- the Fund really doesn't care to have any recovery from the --

MR. POLLACK: We are asserting that the company has a right to determine whether the litigation shall proceed in the first instance and --

QUESTION: Well, do you think you are any more than a nominal defendant whatever that means?

MR. POLLACK: I think that the Fund has an important function in this circumstance and is represented

by the independent directors. If the independent directors had met with Mr. Fox, several things might have happened. Mr. Fox might have been convinced --

QUESTION: That may be true, but the company's position in this case -- The only possible reason for it being a defendant or being a party at all is so it is in the case to receive the money if there is some money.

MR. POLLACK: As a defendant, it in theory cannot receive that money and that, I suppose, goes to the question you asked Mr. Meyer about whether they are improperly aligned.

QUESTION: They can receive it though --

MR. POLLACK: If there is a recovery.

QUESTION: I take it you participated all the way through the courts?

MR. POLLACK: Yes, Your Honor.

QUESTION: Thank you.

MR. POLLACK: The final point about Mr. Meyer's argument, the use of Section 16(b) as an analogy, we think is inapt, because Section 16(b) has its own demand rule.

I would say that, if I may in conclusion, that the blanket and what we view as absolutist disabling of the independent directors of investment companies

by the Second Circuit, which the Second Circuit imposed in Burks and which was repudiated by this Court in Burks, has arisen once again.

The Second Circuit in this case, for whatever reason, seems to have either failed to grasp or decline to follow the logic and spirit of this Court's opinion in Burks and we believe that the Second Circuit should be reversed once again.

Thank you, Mr. Chief Justice.

CHIEF JUSTICE BURGER: Thank you, gentlemen, the case is submitted.

We will hear arguments next in Pulley against Harris.

(Whereupon, at 11:43 a.m., the case in the above-entitled matter was submitted.)

CERTIFICATION

Alderson Reporting Company, Inc., hereby certifies that the attached pages represent an accurate transcription of electronic sound recording of the oral argument before the Supreme Court of the United States in the Matter of:
#82-1200 - DAILY INCOME FUND, INC., AND REICH & TANG, INC., Petitioners v. MARTIN FOX

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BY _____
(REPORTER)