

ADVISORY

SULLIVAN & WORCESTER ADVISORY

U.S. Court of Appeals Overturns Director Independence Rules

The U.S. Court of Appeals for the District of Columbia Circuit ruled on April 7, 2006 that the Securities and Exchange Commission ("SEC") violated the Administrative Procedures Act ("APA") in promulgating a rule that requires registered investment companies under the Investment Company Act of 1940 that rely on certain of the SEC's Exemptive Rules to have (1) boards of directors with at least 75% independent directors and (2) an independent board chair ("Independence Rules"). The Independence Rules, which were originally issued in 2004, were successfully challenged by the U.S. Chamber of Commerce in 2005.

In its 2005 opinion, the Court found that the SEC had failed to determine the costs of complying with the Independence Rules and remanded the case to the SEC. In response to the 2005 ruling, the SEC within a matter of days reconsidered the Independence Rules without reopening the rulemaking record. In so doing, it relied on "publicly available information" to find that the "cost of compliance [would be] minimal."

The Court in its 2006 opinion noted that the SEC reconsidered its Independence Rules on the day before its then chairman was scheduled to resign. In addition, the Court found that the "[SEC] points to no data in the rulemaking record to support its per fund cost estimate for compensation of independent directors overseeing a large number of funds." As a result, the Court overturned the Independence Rules but has stayed this decision for 90 days to "afford the [SEC] an opportunity to reopen the record for comment on the costs of implementing the [Independence Rules]."

Significantly, the Court has found that the SEC has the authority to promulgate the Independence Rules and that courts are generally deferential to administrative agencies that follow the APA. Accordingly, if the SEC follows the APA (by reopening the record) and its current membership continues to support the Independence Rules, another successful challenge to these rules may be difficult.

April 7, 2006
John L. Chilton
Walter Nagel

The Investment Management Practice Group of Sullivan & Worcester LLP has been counseling clients in securities law matters for over forty years.

© 2006 Sullivan & Worcester LLP. Because sound legal advice must necessarily take into account all relevant facts and developments in the law, the information you will find in this Advisory is not intended to constitute legal advice or a legal opinion as to any particular matter.

IF YOU WOULD LIKE ADDITIONAL INFORMATION, PLEASE CONTACT:

Robert N. Hickey
202.775.1205
rhipkey@sandw.com

David M. Leahy
202.775.1201
dleahy@sandw.com

Stacy H. Louizos
212.660.3020
slouizos@sandw.com

David C. Mahaffey
202.775.1207
dmahaffey@sandw.com

Walter Nagel
202.775.1235
wnagel@sandw.com

BOSTON

Sullivan & Worcester
One Post Office Square
Boston, MA 02109

NEW YORK

Sullivan & Worcester
1290 Avenue of the Americas
New York, NY 10104

WASHINGTON, DC

Sullivan & Worcester
1666 K Street, NW
Washington, DC 20006

SULLIVAN &
WORCESTER