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The Basics of Indemnification and Insurance for Investment Company Directors – How do they work? What should I ask?

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I. INTRODUCTION

Both the SEC[1] and The ICI Advisory Group on Best Practices for Fund Directors[2] have strongly recommended that fund boards obtain D&O/E&O insurance coverage and/or indemnification from the fund that is adequate to ensure the independence and effectiveness of their independent directors. In addition to ensuring their independence, fund boards and the SEC have long recognized that adequate indemnification and insurance is critical to attracting qualified persons to serve as independent directors.[3]

Indemnification and insurance are important, since directors have the potential to incur personal liability and can be sued in their capacity as representatives of a fund as a result of a breach or alleged breach of their fiduciary duties of care and loyalty to the fund and its shareholders, or as a result of failing to fulfill their obligations to the fund and its shareholders under federal securities laws. Director liability was not an area of great concern for the nation's corporate directors until the 1980s. Prior to that time, lawsuits against directors for errors in judgment or insufficient care were rare, and relatively inexpensive liability insurance was readily available. Beginning in the 1980s, however, the issue of director liability became an area of increasing concern due to a combination of factors such as (i) increasing numbers of lawsuits being filed against directors, (ii) the potential for large monetary judgments or settlements in derivative and stockholder class action suits, (iii) increasing insurance premiums and deductible amounts for D&O insurance, (iv) decreased availability of D&O insurance and (v) exclusions and limitations in D&O insurance policies. These same circumstances now are a concern to fund directors because of increased litigation directed against them in the past several years.

While relatively unheard of a number of years ago, in recent times shareholders have brought an increasing number of lawsuits against funds and their directors. Suits range from the "traditional" claims of inaccurate prospectus risk disclosure[4] to the more recent claims stemming from common fund industry use of "pooled boards,"[5] to the specialized claims against closed end funds for approval of rights offerings.[6] Additional complications have been introduced in the well-publicized Navellier and Yacktman disputes in which the adviser sued the fund's independent directors.

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[1] Remarks of SEC Chairman Arthur Levitt of the Mutual Funds and Investment Management Conference, Palm Springs, CA (March 22, 1999).

[2] Investment Company Institute, Report of the Advisory Group on Best Practices for Fund Directors, Enhancing a Culture of Independence and Effectiveness (June 24, 1999).

[3] SEC Release No. IC-10700 (May 16, 1979) and SEC Release No. IC-24083 (Oct. 14, 1999).

[4] *E.g.*, In re TCW/DW North Am. Govt. Income Trust Sec. Litig., No. 95C0167, 1997 WL 727487 (S.D.N.Y. Nov. 20, 1997).

[5] Strougo v. Scudder, Stevens & Clark, Inc., 964 F.Supp. 783 (S.D.N.Y. May 6, 1997); In re Nuveen Fund Litig., No. 94C360, WL 328006 (N.D. Ill. June 11, 1996).

[6] Green v. Nuveen Advisory Corp., 186 F.R.D. 486 (N.D. Ill. 1999).

II. QUESTIONS THAT INDEPENDENT DIRECTORS SHOULD ASK ABOUT INDEMNIFICATION AND INSURANCE

- What is indemnification and how does it work?
- Am I indemnified to the fullest extent permitted under applicable state and federal law?
- Do I have a right to advancement of expenses, and if so, how do I exercise this right?
- Should I have a separate indemnification agreement with the Fund?
- Does the Charter have an exculpation clause?
- Should the Fund and the directors obtain D&O/E&O insurance coverage?
  - How much coverage?
  - Which insurance provider?
  - What are the terms of the coverage?
- Should the Fund(s) and the Adviser obtain a "joint" insurance policy?
  - What are the legal standards and findings I must make to approve a joint policy?
  - Who should pay the premiums and how much?
  - How is coverage allocated among the insureds?
- Should we get a separate policy for the Independent Directors?

III. INDEMNIFICATION — THE STARTING POINT

A. Indemnification — A Creature of State Law

Corporate indemnification of directors has its genesis in agency law.[7] In essence, prior to the advent of indemnification statutes, directors argued that, as "agents" for the corporation, they were entitled to reimbursement of their costs (including litigation expenses and damages) incurred in service of the corporation. The courts, however, did not warm to this approach, and early suits brought by directors for recovery of defense costs were not very successful.[8]

[7] Under traditional agency theory, an agent acting within the scope of his duties is an instrument of his principal's will. Accordingly, the principal must take responsibility for the losses of the agent that are suffered in the good faith execution of the agency, as long as the agent does not know or have reason to know that his performance of such duties would be illegal or unjustifiable. Corporate directors, however, do not fit the conceptual mode of agents because, for certain purposes, directors are the masters of the corporation and not its servants, and because they derive the basis of their authority not simply from the shareholders but from state corporation acts.

[8] *E.g.*, DuPuy v. Crucible Steel Co., 288 F. 583 (W.D. Pa. 1923); Hoch v. Duluth Brewing & Malting Co., 173 Minn. 374, 217 N.W. 503 (1928).

The impetus for states to enact statutes permitting indemnification for directors finally arose out of the many lawsuits brought against corporate directors as a result of the Great Depression. In many of those instances, decisions made in good faith in those difficult circumstances appeared very ill-conceived in hindsight. Indeed, a leading court held that corporate directors could not be indemnified *even though* the directors and the corporation prevailed in the suit.[9]

In response to the criticism of such a result, in 1941 the state of New York enacted the first indemnification statute. Today, all 50 states have indemnification statutes.

While variations exist among the state indemnification statutes,[10] many state laws:

- require indemnification for attorneys' fees and expenses of a director who has been fully exonerated.
- permit a corporation or business trust to include provisions in their charter/bylaws or trust documents to permit indemnification of amounts paid in judgment or settlement and defense costs where the director acted in good faith.
- do not permit indemnity for conduct that involves bad faith, willful misfeasance, reckless disregard of duty or that resulted from active and deliberate dishonesty, improper personal benefit or in a criminal proceeding, where the director knew or had reasonable basis to know that his conduct was unlawful.
- provide a mechanism so that a fund can make a determination as to whether indemnity is proper. The statutes commonly provide that the determination can be made:
    - by a majority vote of the board of directors or by a committee of directors not involved in the proceeding;
    - by special legal counsel selected by the board or committee of the board to make the determination; or
    - by the stockholders.

In addition to the traditional manner of including indemnification provisions in a fund's charter or bylaws, most state laws also permit directors to enter into indemnity agreements with the fund. Such an agreement may be desirable because it gives the directors an additional contractual basis to make a claim against the fund, secures indemnity rights in the event the board determines to change the bylaws, and clarifies and amplifies the directors' indemnification

[9] New York Dock, Inc. v. McCollum, 173 Misc. 106, 16 N.Y.S.2d 844 (1939).

[10] A summary of the relevant state law for three common forms of investment company domiciles is included as Annex A (Maryland corporation, Massachusetts business trust, and Delaware business trust).

rights. A sample form of an indemnification agreement for a fund organized as a Maryland corporation is attached as Annex B.

B. Advancement of Expenses — A Very Important Offshoot

A key issue when a suit is filed or claim is made is whether directors are entitled to advancement of expenses.[11] Litigation is a time consuming and expensive process, and it is important to consider the ability of the directors to have monies advanced to pay legal fees and expenses in defense of the lawsuit. It is important, then, that there be a provision that provides that expenses of preparation and presentation of a defense to a claim be advanced by the fund prior to final disposition.[12] Usually, this is conditioned upon an undertaking by the recipient to repay such amounts if it is ultimately determined that the director is not entitled to indemnification. As discussed below in Section D., under the 1940 Act, in order to get an advancement of expenses, the SEC staff believes one of the three following circumstances must exist:

- the director provides security for his undertaking to repay the advance; or
- the fund is insured against losses arising out of any such advances; or
- a determination is made based upon a review of readily available facts (as opposed to a full trial-type inquiry) that there is a reason to believe that the director ultimately will be found entitled to indemnification by either:
    - a majority of disinterested directors acting on the matter; or
    - independent legal counsel in a written opinion.

C. Exculpation Clauses

Recently, many states have expanded their statutes to allow a corporation to include in its charter an exculpation clause, which eliminates or reduces a director's personal liability for monetary damages. For example, the Delaware General Corporation Law permits a provision "eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such a provision shall not eliminate or limit the liability of a director (i) for any breach of the director's duty of loyalty to the corporation or its stockholders, [or] (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law . . . ."[13]

Exculpation clauses have not been tested extensively by the courts. In addition, exculpation clauses cannot supercede the federal securities laws, including the 1940 Act (*see* Section D. below — Federal Law Limits).

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[11] The right to an advancement of expenses is "separate and distinct" from any indemnification rights.

[12] An advancement of expenses can be either permissible or mandatory.

[13] Delaware General Corporation Law Section 102(b)(7).

D. Federal Law Limits

1. Indemnification

The 1940 Act limits the ability of a fund to indemnify its directors. Consistent with the laws of many states, the 1940 Act prohibits indemnification for any liability to the company or its security holders where the director has engaged in willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his office ("disabling conduct").[14] Courts and the SEC have also generally taken the position that indemnification against federal securities law liabilities is contrary to public policy and is therefore unenforceable.[15]

The SEC staff also requires that indemnification provisions set forth reasonable and fair means for determining whether indemnification shall be made.[16] In the staff's view, "reasonable and fair means" would include:

- a final decision on the merits by a court or other body before whom the proceeding was brought that the person to be indemnified was not liable by reason of disabling conduct; or[17]
- 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:
  - the vote of a majority of a quorum of directors who are neither "interested persons" of the fund nor parties to the proceeding ("disinterested, non-party directors"); or

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[14] Section 17(h) of the 1940 Act provides: " . . . neither the charter, certificate of incorporation, articles of association, indenture of trust, nor the by-laws of any registered investment company, nor any other instrument pursuant to which such a company is organized or administered, shall contain any provision which protects or purports to protect any director or officer of such company against any liability to the company or to its security holders to which he would otherwise be subject by reason of willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his office."

[15] Under the Securities Act of 1933, a registrant must describe in its prospectus the provisions relating to indemnification of its directors, officers, and controlling persons against liability under the Act, and include a statement similar to the following:

> Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers [or controlling persons], the registrant has been informed that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is therefore unenforceable. . . . *See also* Globus v. Law Research Serv., Inc., 418 F.2d 1276, 1288 (2d Cir. (N.Y.) 1969), cert. denied, 397 U.S. 913 (1970)… .

[16] SEC Release No. IC-11330 (Sept. 4, 1980).

[17] The staff also stated that the dismissal of either a court action or an administrative proceeding against an indemnitee for insufficiency of evidence of any disabling conduct with which the person has been charged would provide reasonable assurance that the indemnitee was not liable by reason of disabling conduct. Id.

- an independent legal counsel in a written opinion.[18]

These procedures usually work effectively with respect to making *final* determinations regarding the right to indemnification. In such instances, either a court or other adjudicative body has made a final decision that the indemnitee was not liable by reason of disabling conduct or the parties have entered into a settlement, in which the directors do not admit any wrongdoing or liability. At that point, the indemnification issue normally would be submitted to a quorum of directors not parties to the proceeding or to an independent legal counsel for a determination. This determination is relatively straightforward after settlement or other conclusion of the matter, since the board or counsel generally has access to all readily available facts, including documents produced and testimony developed in pretrial discovery in the litigation.

The SEC staff's procedures can pose difficulties, however, in dealing with the issue of advancement of expenses. They may also pose issues in a adversarial change of control situation, particularly if the former directors must seek approval from the new board, which may not consider the matter objectively on the merits.

2. Advancement of Expenses

In the very important area of advancement of expenses, the SEC staff also takes the position that there must be a reasonable and fair means for determining whether an advancement should be made. As with ultimate indemnification, the SEC staff has set forth what it believes is a "reasonable and fair means" to include an undertaking by the indemnitee to repay the advance unless it is ultimately determined that the person is entitled to indemnification and one of the following:

- the indemnitee shall provide security for the undertaking; or
- the fund shall be insured against losses arising by reason of any lawsuit advances; or
- a determination, based on a review of readily available facts (as opposed to a trial-type inquiry), that there is reason to believe that the indemnitee ultimately will be found entitled to indemnification by:
    - either a quorum of the board (as described above); or
    - independent legal counsel.[19]

Quite often, directors seek an opinion from independent legal counsel in satisfying the SEC staff conditions. Complications and difficulties can arise, however, in employing independent legal counsel to make the advancement determination. In Yacktman, for

[18] The independent legal counsel should not represent or be affiliated with the fund, any individual director or officer, the adviser, the principal underwriter or any affiliate of these persons or entities to avoid claims of a lack of independence.

[19] SEC Release No. IC-11330 (Sept. 4, 1980).

example, independent counsel was engaged by the directors while litigation was pending between the adviser and the independent directors. The independent counsel determined that he was unable to render an opinion because, in light of the pending litigation, he did not have access to all required facts (those in sole possession of the adviser and its witnesses) while the action proceeded. This left the directors without a viable mechanism to obtain advancement of expenses that would satisfy state and federal laws. In order to ameliorate this problem, however, the SEC staff, in a no-action letter, said the independent counsel could proceed to issue an opinion permitting advancement under a rebuttable presumption that the directors did not engage in disabling conduct.[20] Such a presumption could be rebutted by evidence that the directors had engaged in such conduct. Subsequent to Yacktman, the SEC staff also extended this rebuttable presumption to situations when the disinterested, non-party directors make the reasonable belief determination.[21]

3. Cannot Insure Non-Indemnifiable Conduct

The SEC staff has stated its belief that Section 17(h) of the 1940 Act, which prohibits a fund from directly indemnifying a director from disabling conduct, also precludes the fund from indirectly indemnifying the director by insurance.[22] The SEC staff has indicated, however, that directors could obtain insurance to cover disabling conduct if they pay for it themselves.[23] The SEC staff's view is more restrictive than most state laws[24] which allow insurance for conduct that would not be indemnifiable, subject to certain limitations. No significant court has decided whether the SEC staff is correct in its view of the 1940 Act's limitation on insurance.

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[20] The Yacktman Funds, Inc. (pub. avail. Dec. 18, 1998).

[21] SEC Release No. IC-24083 (Oct. 14, 1999). The SEC staff also stated its view that disinterested, non-party directors or independent legal counsel must make a reasonable belief determination prior to each advance of legal fees to fund directors (such a determination should include the consideration of any new information that is readily available).

[22] *See* Item 19 of the Guidelines for the preparation of Form N-8B-1 registration statement for open-end funds (the predecessor to current Form N-1A) issued by the SEC staff, which provides: "[i]t is the Staff's position that Section 17(h) does not prohibit the [fund] from paying for insurance which protects the directors against liabilities arising from action not involving willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of their offices. *The Staff would regard insurance paid for by the [fund] covering any of the enumerated categories as involving a violation of Section 17(h)* unless it merely provided for payment to the [fund] of any damages caused by a director or officer, and also provided that the insurance company would be subrogated to the rights of the [fund] to recover from the director or officer. It is therefore the staff's position that when 17(h) prohibits a fund from directly indemnifying a director, it also precludes the fund from indirectly indemnifying him by means of D&O insurance." (Emphasis added.)

[23] SEC Release No. IC-10891 (Oct. 4, 1979).

[24] *See, e.g.*, MGCL 2-418(k); Mass. Law. 156B 67; Olson & Hatch, Director and Officer Liability 10-6-10-10 (West Group 1998).

IV. D&O/E&O INSURANCE

A. What is D&O/E&O Insurance?

D&O/E&O Insurance policies generally provide two types of coverage: (1) "directors and officers" (D&O) and (2) "errors and omissions" (E&O). D&O coverage typically *covers directors* (and officers) of a fund for claims made against them for their designated acts, errors or omissions. E&O coverage typically *covers the fund* for claims made against the fund for designated acts, errors or omissions by the fund or its representatives (*e.g.*, its directors and officers).

Generally, there are two types of D&O coverage: (1) "fund reimbursement" and (2) "direct." Fund reimbursement coverage covers the fund for amounts that the fund has indemnified or is required to indemnify. Fund reimbursement coverage is the most common type of coverage. Direct coverage, on the other hand, covers directors if the fund is not legally permitted to indemnify them. Direct coverage for investment company directors is rare, since, as discussed above, the SEC staff takes the position that, for most practical purposes, it is not permitted under the 1940 Act.

There are also two general types of D&O/E&O policies: (1) "claims made" and (2) "occurrence." Most funds have claims made policies. Under a claims made policy, coverage is triggered when a claim is made against an insured. Under an occurrence policy, coverage is triggered when the facts underlying the claim occur. Under either type of policy, giving timely notice of a claim (or potential claim) is of critical importance, since failure to do so could result in a denial of coverage.

Subject to certain limits and exceptions, insurance can provide directors with protection when indemnification cannot (such as for certain federal securities law liabilities).

B. Issues Associated with Joint Policies

Funds often purchase D&O/E&O policies on a joint basis with the adviser (and its affiliates) because frequently this is the most cost-effective method to obtain coverage. A joint policy often allows each insured to obtain more aggregate coverage and/or lower premiums. Such joint policies are permissible under Rule 17d-1(d)(7) under the 1940 Act provided that:

- the fund's participation in the joint policy is in the best interest of the fund;
- the proposed premium for the joint insurance policy to be allocated to the fund, based upon the proportionate share of the sum of the premiums that would have been paid if such insurance coverage were purchased separately by the insured parties, is fair and reasonable to the fund;

- the board of directors of the fund, including a majority of the directors who are not interested persons with respect thereto, determine at least annually that the standards described above have been satisfied;[25]

- the joint insurance policy does not exclude coverage for bona fide claims made against any director who is not an interested person of the fund, or against the fund if it is a co-defendant in the claim with the disinterested director, by another person insured under the joint insurance policy;

- a majority of the directors of the fund are not interested persons of the fund and those directors select and nominate any other disinterested directors of the fund; and

- any person who acts as legal counsel for the disinterested directors of the fund is an "independent legal counsel."[26]

The use of a joint policy presents the tricky issue of how to allocate the premium; first, between the funds and the adviser, and, second, between each of the funds. Often, fund boards will seek an estimate from the insurer of the costs of separate policies for the funds versus the adviser and apply that percentage in allocating the premium between the funds and the adviser. While this percentage may vary widely among fund complexes, typically the insurer will apply a higher percentage to the adviser (*e.g.*, 60/40% split). In the next step, allocating the premium among the funds, boards consider factors such as the relative riskiness of each fund, the number of shareholders and the amount of net assets.

A joint policy also exposes one or more insureds to the risk that the limits of the policy may be exhausted by another insured. This is because D&O/E&O insurance coverage is typically "aggregate" coverage, as opposed to "each and every occurrence" coverage. Under an aggregate coverage policy, each loss decreases the total amount of coverage until the amount of coverage is exhausted. One way that fund boards address the issues of an aggregate coverage policy is to have the insureds enter into an agreement that guarantees each insured some minimum amount of coverage and allocates coverage among the insureds in the event there is a loss in excess of the total policy.[27] A sample form of an allocation agreement is attached as Annex C.

C. Scope and Limits of Coverage

All insurance is not created equal. There are various types, and many terms, of D&O/E&O insurance. The policy is a complicated and elaborate system made up of various parts, many of which can function to deny or limit coverage. **Directors should focus not just on the dollar amount of the coverage or the dollar amount of the premium.**

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[25] In the release adopting Rule 17d-1(d)(7), the SEC said that this annual review is necessary even with a multi-year policy. SEC Release No. IC-10891 (Oct. 4, 1979).

[26] *See* Rule 0-1(a)(6) for a definition of "independent legal counsel."

[27] Often, an allocation agreement will provide that each covered fund shall recover the full amount of its loss before the adviser can recover any portion of its loss.

1. Policy Structure

D&O/E&O insurance policies have traditionally been based on the Lloyds of London form, which uses a two-part structure. One part, "Part A" insures directors and officers in situations where the fund cannot or does not provide indemnification. "Part B" reimburses the fund for indemnification payments properly and lawfully made.

Under Part A, the insurer agrees to pay all "Loss" resulting from a "Wrongful Act" for which the directors become legally obligated to pay, except for such Loss for which the fund (1) actually pays in indemnification or (2) is legally permitted to indemnify the directors but does not pay, unless the failure to pay is due to the financial incapability following bankruptcy or receivership.[28]

As noted above, most D&O/E&O policies available today are "claims made" policies. Under this type of policy, coverage applies to claims first made during the policy period regardless of when the events giving rise to the claim occurred. This means that if a claim is not made while the insurance is in effect, no coverage exists even if the operative events took place while the policy was in force. This approach differs from other types of insurance such as general liability policies where coverage attaches to the policy in effect at the time of the occurrence of the events giving rise to coverage. Disputes can arise under D&O/E&O policies as to what constitutes a claim and when the claim was first made. A closely related concept is the "retroactive date" or prior acts date. This is the starting point for coverage under the policy and is the first date in which alleged wrongful acts may occur and be covered. This date is of central importance to the coverage provided; for example, a retroactive date the same as the policy inception date would limit coverage severely. This date is an important subject of negotiation.

The first page of the policy typically is the "Declarations Page," which sets forth the policy period (frequently one year, but sometimes two or three years) and the name of the insureds. The Declarations Page also sets forth the limit of liability for each coverage. It also specifies the deductibles or retentions applicable to each claim and coinsurance provisions, if any. Coinsurance provisions are not common in today's insurance market.

Normally, there is no deductible for claims under Part A, the director's coverage. Under Part B, the fund's coverage, the deductible is usually substantial. Deductibles of $500,000 to $1 million are not uncommon for large funds.

Next, there is a series of definitions for key terms such as "Claim," "Loss," and "Wrongful Act," which must be reviewed with particular attention, as they materially affect the extent of coverage offered by the policy.

The next part of the policy is an exclusion section describing broadly those areas of liability that the policy does not cover.

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[28] A potential for disputes exists if a fund makes a determination that it is not legally permitted to indemnify the directors and the insurer takes a contrary view. This circumstance could occur in the aftermath of a proxy fight if the directors engage in litigation with the adviser and a new board makes the determination regarding indemnification. The former adversaries may decide the prior directors' actions were not taken in good faith while an objective observer would conclude otherwise.

General terms and conditions of the policy establish important procedures, presumptions and conditions to coverage, including provisions relating to notice of claims, the insured's rights with respect to defense of claims and circumstances in which the policy may be canceled. A particularly important provision here is the one that describes when the insurer will advance expenses to the insured.

Finally, at the end are the endorsements, a series of "side agreements" between the policyholder and the insurer. These endorsements can have a significant practical effect in enhancing or diminishing the coverage of the policy.

2. Definition of Key Terms

a. "Claim"

While actions brought in court for damages should clearly constitute a "Claim," various D&O/E&O policies have differing definitions of "Claim" and certain policies do not include governmental or other regulatory investigations within their scope. More comprehensive policies explicitly include coverage for investigations into possible violations of law or regulation initiated by a governmental body or self-regulatory organizations, as well as more commonly covered court proceedings. Sometimes, it is not clear whether a "Claim" was made in a particular policy period. For example, a dispute may arise as to whether a letter from a government agency constitutes an "investigation" as opposed to an inquiry.

b. "Loss"

The definition of "Loss" has provoked disputes as to scope of coverage. "Loss" is the amount that the directors of the fund are legally obligated to pay for Wrongful Acts and includes damages, judgments, settlements consented to by the insurer and costs of defense. D&O/E&O policies frequently provide that the Loss shall ***not*** include fines, penalties, matters uninsurable under applicable law, taxes, punitive or exemplary damages, or the excess portion (two-thirds) of treble damages.[29]

c. "Wrongful Act"

"Wrongful Act" with respect to D&O/E&O coverage typically is defined to mean any actual or alleged error, misstatement, misleading statement, negligent act or omission, or neglect or breach of duty by the directors and officers in the discharge of their duties solely in their capacity as directors and officers of the fund. Disputes can arise as to whether "intentional" as opposed to negligent acts are insured.[30] Generally, insurance companies tend to insure against negligent acts and not intentional wrongdoing. Policy exclusions sometimes further limit the definition, for example by stating that there is no coverage for fraudulent or dishonest acts or the intentional violation of law by the insured. Courts have ruled

[29] The laws of many states prohibit payment of punitive damages, even if such an award is covered under the policy.

[30] For example, Anderson Newton Theological Sch., Inc. v. Continental Cas. Co., 930 F.2d 89 (1st Cir. 1991) (coverage denied for age discrimination claim, applying Massachusetts law).

that "intentional" conduct that was not intended to cause harm is covered, but these lines are sometimes difficult to draw.[31] Claims also have arisen as to whether a director was acting solely in his capacity as a director.

3. Exclusions

a. Claims Against Co-Insureds

D&O/E&O policies typically include an exclusion for claims brought by one insured against another. Generally, the exclusion does not apply to derivative suits. The reason for this exclusion is to avoid providing insurance for collusive suits between insureds designed to reach insurance coverage. Such an exclusion, however, may cause a director to be without coverage, for example, in the event of litigation brought by the investment adviser. The D&O/E&O carrier in the Yacktman dispute declined coverage for this reason. The ICI Advisory Group and the SEC both have warned directors to be sure their policies do not contain such an exclusion in order to ensure their independence. Moreover, in 2001, the SEC amended Rule 17d-1(d)(7) to prohibit the use of a joint insurance policy containing an exclusion for claims against an independent director by a co-insured (*e.g.*, the adviser).

b. Other Common Exclusions

D&O/E&O policies generally contain several other limitations on coverage. Often, no coverage exists for any loss:

- arising out of fraudulent, dishonest or criminal acts, or intentional violation of law;
- based upon the insureds gaining any profit or advantage to which they were not legally entitled;
- for return by directors to the fund of any remuneration held to be a violation of law;
- consisting of short swing profits under § 16(b) of the Securities Exchange Act of 1934;
- based upon bodily injury, personal injury or damage to tangible property and certain other risks customarily covered by other insurance policies;
- for which the insured is entitled to indemnify under any other policy;
- arising out of discrimination based upon race, sex or national origin;

[31] Atlanta Permanent Fed. Sav. & Loan Ass'n. v. American Cas. Co., 839 F.2d 212 (4th Cir. 1988) (coverage found where conduct was volitional but not intended to cause injury).

- arising out of discharge of duties as directors, officers or trustees of any entity other than the named insured, even if requested to do so by an insured;

- arising out of the adoption, implementation or termination of a plan under Rule 12b-1 under the 1940 Act; or

- relating to payment to the adviser (or an affiliate) of management, investment advisory or other fees.

4. Important Procedures

a. Notice of Claim

D&O/E&O policies typically provide that notice of a claim must be received by the insured during the policy period, and that the insured must give notice of the claim to the insurance company within the policy period, or sometimes within a short period after it ends (generally 30 days). Many policies permit advance reporting of circumstances that may give rise to a claim. If such circumstances are reported in accordance with the policy's requirements, the result is that any claim arising from the reported circumstances subsequent to the policy period will be deemed a claim in that policy period.

b. Selection and Payment of Counsel

Selection of counsel and the reasonableness of "costs of defense" also can raise issues. Normally, the directors have the right to select their own counsel (subject to the reasonable approval of the insurer) and to direct their own defense. Suits alleging wrongdoing by fund directors frequently involve very complex issues and a very large potential exposure. The directors have a strong interest to obtain the best legal representation available from attorneys experienced in investment company issues. Insurance companies generally are cost conscious with respect to rates and activities undertaken by the directors' attorneys. Disputes can arise as to the counsel to be retained and reasonableness of hourly rates and fees sought to be reimbursed.

c. Advancement of Attorneys' Fees & Costs

Certain D&O/E&O policies are not clear as to whether the insurer is required to advance attorneys' fees and costs, and disputes and litigation have arisen concerning this issue. It is very important that the policy clearly provides that the insurer, upon request, shall advance costs of defense on behalf of the directors. Certain policies, similar to corporate indemnification provisions, require that the directors give a written undertaking that, in the event it is established that the insurer has no liability, the directors shall repay the sum advanced, and the insurer shall have no obligation to advance costs of defense if it has reasonable grounds to believe that it will not ultimately have liability for Loss resulting from the claims.

D. "Topical" Issues to Consider

1. Separate Coverage for Independent Directors

As noted above, a joint policy covering the Adviser, the Funds and the directors is often the most cost-effective method to obtain insurance coverage. A joint policy, however, can leave a director (particularly an independent director) vulnerable to a claim in certain situations (particularly situations involving a dispute with the Adviser). Many independent directors, therefore, have obtained separate coverage for themselves. Such coverage can offer protection against various risks, including:

- Navellier Risk – The risk that the Adviser terminates the policy.
- Yacktman Risk – The risk that an insured vs. insured exclusion restricts or precludes coverage.[32]
- Exhausted Coverage Risk – The risk that claims of co-insureds will exhaust the coverage remaining for the independent directors.
- Cancellation Risk – The risk that the insurer may cancel the policy.
- Rescission Risk – The risk that the insurer may rescind the policy.
- Bankruptcy Risk – The risk that a co-insured's bankruptcy may preclude use of the policy limits for directors.

2. Enhancements for a Joint Policy

Short of obtaining a separate policy for the independent directors, the existing joint policy can be enhanced by providing for:

a. Automatic Reinstatement of Coverage for the Independent Directors if Policy Canceled

If a policy is canceled by a co-insured, such as the adviser, independent directors may find themselves with no coverage. This is what happened in "Navellier." The adviser canceled the policy, which left the directors without coverage. Independent directors should consider an endorsement that allows independent directors to prepurchase a right of reinstatement of coverage that can be exercised in the event coverage is canceled by someone other than the independent directors.

b. Reserved Limits

To address exhausted coverage risk, independent directors should consider an enhancement that offers coverage reserved exclusively for independent directors. This is an

[32] As required by amended Rule 17d-1(d)(7), joint policies, now, may not contain most of the troublesome language under an insured vs. insured exclusion; *see* SEC Adopting Release No. IC-24816 (Jan. 2, 2001).

alternative to purchasing a separate policy just for the independent directors. It takes advantage of the lower pricing accorded "joint policies," yet preserves limits for the sole use of the independent directors.

c. Special Notice and General "Corporate Machinery" Provisions

D&O/E&O policies generally provide for a single named insured (usually the adviser) to act as agent for the other insureds (*e.g.*, to receive notice in the event of cancellation of the policy and to operate the general "corporate machinery" of the policy). Independent directors should consider an enhancement that ensures that specific notice of cancellation of the policy will be provided to the independent directors, along with the ability to exercise the general corporate machinery of the policy.

d. Bankruptcy Enhancement

In several recent cases (not involving investment companies), courts have ruled that the D&O policy proceeds, due to inclusion of a corporate entity in the policy that files for bankruptcy, are part of that corporation's assets and awarded the bankruptcy trustee the proceeds to satisfy creditors. As a result, directors named in lawsuits were denied or given limited access to their D&O policy by the courts. Independent directors of investment companies should consider obtaining separate (or reserved) coverage to guard against this risk, or entering into an agreement with co-insured entities reserving coverage for them.

3. Severability Language

Independent directors should insure that their D&O policy contains a severability clause. A severability clause ensures that misrepresentations or disabling conduct by a co-insured is not imputed to any other party.

4. Restatement of Financial Statements

In a few recent high profile cases (*e.g.*, Enron), insurers have attempted to rescind coverage as a result of a restatement of financial statements (since the policy was, presumably, issued based upon the insurers understanding that an insured's financial statements were accurate). Moreover, some insurers are now seeking to include exclusions for claims resulting from a restatement of financial statements. Independent directors should ensure that their policy does not include such an exclusion and/or address what would happen if an insured restated its financial statements (for example, if a fund restated its financial statements due to a significant write-down in valuation of its holdings).

5. Independent Director Non-Party Witness Expense

In recent mutual fund litigation, the fund's independent directors have been deposed as non-party witnesses. (The legal expenses associated with representing independent directors in such depositions can be significant.) Independent directors should review whether their D&O policy covers expenses associated with being called to testify as non-party witnesses.

6. Marital Extension

Independent directors should consider an enhancement to their D&O/E&O policies that extends coverage for spouses of independent directors. The coverage is for claims made against such spouses in their capacity as spouses for the wrongful acts of the independent directors (including claims seeking damages recoverable from marital community property jointly held by the director and spouse).

7. Travel Insurance

Independent directors should consider separate coverage for injuries sustained by directors as a result of an accident or injury while on the business of the fund.

V. FROM THE TABLOIDS—DISPUTES BETWEEN ADVISERS AND INDEPENDENT DIRECTORS

Typically, the need for indemnification and insurance coverage has arisen when shareholders sue the fund, alleging such claims as improper disclosures in the prospectus, improper rights offerings or fees paid to the adviser. In the last few years, two unprecedented situations arose where the independent directors and the adviser became involved in a dispute resulting in litigation initiated by the adviser. The tactics employed in these disputes raised serious questions as to whether the directors could maintain their independence in the face of threatened financial ruin and led to a round table discussion sponsored by the SEC and the Report of the ICI Advisory Group.

A. Navellier

The Dispute. Navellier, an adviser owned by Louis Navellier ("Navellier"), and the independent directors had serious disagreements because Navellier refused to provide financial and other information concerning its operation of the fund requested by the directors. Navellier claimed that the disagreements arose because the independent directors: (i) sought confidential, non-relevant financial information; (ii) desired to retaliate because of Navellier's firing of the fund's marketing director, who was an interested member of the Board and a friend of two of the independent directors; and (iii) wanted to perpetuate themselves in office to continue to collect fees of $20,000 per year. Unlike the Yacktman dispute discussed below, Navellier did not involve poor performance, since the fund was doing well prior to and during the dispute.

As the dispute continued, Navellier proposed to merge the existing load fund into a no-load fund it also managed, thus removing the directors from the fund's Board. The independent directors refused to consider the merger proposal until they received information that they deemed necessary to make an informed decision. During a one-year period while the parties discussed the information requests, the Board extended the investment advisory agreement for short periods of time.

The Proxy Contest. After a year of "discussions" with the Board, Navellier prepared and filed a proxy statement seeking shareholder permission to effect the proposed merger. Navellier also claimed its advisory contract was terminated by the Board. To the contrary, the independent directors claimed that Navellier had resigned. The independent directors then took

steps to remove Mr. Navellier from the Board and entered into a contract with a new adviser to take over management of the fund. In accordance with the 1940 Act, they sought shareholder ratification of the new adviser by soliciting proxies approving the change.[33] While the proxy fight raged, the adviser filed litigation that sought to enjoin the independent directors from removing Mr. Navellier as an interested director. Navellier also sought an injunction to block the directors' efforts to obtain ratification of the new investment advisory agreement.

Ultimately, the independent directors did not obtain the requisite vote of shareholders to approve the new adviser. The independent directors, stymied in their efforts to replace Navellier, then entered into a new advisory contract with Navellier and resigned. But that was not the end of the story, or the agony, for the independent directors.

The Damage Lawsuit. Navellier filed an amended complaint against the independent directors, the new (proposed but rejected) adviser and the attorney for the independent directors. The suit alleged that the independent directors breached their fiduciary duties under both state and federal law because:

- the directors took actions against Navellier in retaliation for its firing of the marketing manager; and
- the directors sought to entrench themselves on the board so they would continue receiving their $20,000 per year directors' fees.[34]

The plaintiffs also alleged that the directors wasted corporate assets by engaging in the proxy contest and by hiring an attorney. Finally, in a claim that had large potential damages, Navellier alleged that the directors intentionally interfered with its economic prospects and sought recovery of lost advisory and administrative fees for the period it was removed as adviser.

The Attempted Class Action. Navellier recruited several friendly shareholders and attempted to bring the case as a class action on behalf of: (a) all shareholders who redeemed their shares after the new adviser was appointed (approximately 4,000) and (b) all shareholders who remained in the fund (also about 4,000). Navellier alleged that all shareholders were injured because they prematurely had to pay capital gains tax. The new adviser sold many of the fund's holdings and, as a result, the fund realized significant capital gains. This would have been an extremely large claim for damages given the number of shareholders. The Court refused to certify this class, so the case proceeded only on behalf of Navellier, Mr. Navellier personally and the individual shareholders.

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[33] Rule 15a-4 under the 1940 Act provides that a contract with a new investment adviser must be approved by a majority of the outstanding voting securities within 150 days after termination of the prior adviser's contract. (At the time of Navellier, the limit was 120 days.)

[34] Navellier alleged that these claims were supported by the following facts: the directors were upset with the firing of the marketing manager, wrongfully resisted the merger proposal, failed to renew the adviser's (Navellier) contract, ousted Mr. Navellier from the Board, demanded privileged personal financial information from Navellier, interfered with the SEC's review of the potential proxy vote on the merger and had an agreement with the new adviser to remain as Board members.

The Directors Prevail at Trial. The case then proceeded to trial before a jury, and the amount of claimed damage was reduced even further. Mr. Navellier personally claimed less than $10,000 in capital gains under his theory of damage. The other individual plaintiffs did not show up to testify, so their relatively modest individual claims for excess capital gains were dismissed. The corporate waste claim was limited to about $225,000, the amount spent in the proxy contest to substitute the new adviser for Navellier. The court rejected Navellier's argument that this damage claim should include expenses relating to the proxy contest concerning the merger proposal and attorneys' fees and expenses incurred to advise the independent directors and defend the litigation.

The independent directors testified and explained the reasons for their actions—that they acted in a manner that they believed was in the best interest of the shareholders. The jury found in favor of the directors.[35] One key fact that helped the defense was that the independent directors had agreed to step aside after the new adviser was in place, which took the force out of the Navellier's entrenchment argument.

Mr. Navellier appealed the jury's decision to the Ninth Circuit Court of Appeals. On August 27, 2001, the court rejected Mr. Navellier's claims and upheld the jury verdict "exonerating the independent trustees."[36] Notwithstanding the fact that the independent trustees eventually prevailed, the Navellier saga was a costly, time consuming process that reinforces, among other things, the need for independent trustees to be adequately covered by indemnification and insurance.[37]

B. Yacktman

The Dispute. Yacktman also involved a dispute between an adviser, owned and controlled by Don Yacktman, and the fund's independent directors. In this instance, the independent directors had questioned the adviser with respect to an apparent deviation in investment technique, the appropriate use of derivatives, violations by certain adviser employees of the fund's code of ethics, the management of the fund's portfolios by individuals other than those named in the prospectus, and the depth and experience of investment management personnel employed by the adviser. In addition, the independent directors expressed substantial concern that the fund's investment performance had been very disappointing.

In response, the adviser sent a letter to the independent directors demanding that they resign or a proxy statement would be filed seeking their replacement. The letter threatened personal financial ruin if they opposed the adviser. The independent directors refused to resign. The president of the adviser (who was also the president of the fund) then called a special meeting of shareholders to remove the independent directors and replace them with a slate of

[35] The principal witnesses at the trial were Mr. Navellier and the independent directors. Other witnesses by videotape and written depositions included Navellier employees, representatives of the new adviser, the attorney for the independent directors and officials of the SEC.

[36] Navellier v. Sletten, 262 F.3d 923 (9th Cir. 2001).

[37] *See*, James B. Graver, "Navellier v. Sletten – Exoneration for Mutual Fund Independent Trustees," The Investment Lawyer (December 2001) for a historical review of the Navellier saga.

directors chosen by the adviser. The adviser also filed a preliminary proxy statement with the SEC.

The SEC Does Not Enjoin the Meeting. The board revoked the call of the meeting and removed the president from office. The independent directors sent a letter to the SEC seeking intervention to stop the solicitation of proxies by the adviser. In this letter, the independent directors stated that they had attempted to fulfill their responsibilities as "watchdogs for the shareholders" by expressing their concerns. The independent directors expressed the view that the adviser's actions constituted an attempt to control the fund's independent directors. In addition, the independent directors stated that they believed the adviser's actions constituted a breach of the adviser's fiduciary duty to the fund in violation of Section 36(a) of the 1940 Act, and that, if allowed to stand, the adviser's actions would have a chilling effect upon independent directors of investment companies throughout the industry. The SEC commenced an inspection of the fund, but did not seek to stop the meeting.

The Suit. The adviser then sued the fund and the independent directors in Maryland state court, seeking to compel holding of the shareholders meeting and, based upon Section 17(d) of the 1940 Act, to prohibit the fund from spending its own assets to solicit proxies for its own meeting. The state court judge, among other things, issued a temporary restraining order ("TRO") prohibiting the fund from spending its own assets to counter the adviser's proxy solicitation. The SEC staff then issued a letter that called into question the judge's ruling, saying that such a ruling could severely undermine the ability of independent directors to perform their duties under the 1940 Act. The fund immediately removed the case to federal court, and the district judge vacated this portion of the TRO, allowing the fund to finance its own counter-solicitation.

The Adviser Prevails. At the shareholders meeting, by a narrow margin, Yacktman obtained enough votes to remove the independent directors.[38] This vote, however, did not reflect the fact that the holders of approximately 64% of the fund's shares had "voted with their feet" by redeeming their investments in the fund. The Funds' shares decreased from 81 million shares ($1.14 billion in assets) on January 1, 1998, to 29 million shares ($0.4 billion in assets) on November 24, 1998, the date of the shareholders meeting.

Yacktman then dismissed the lawsuit with the agreement of the independent directors and, as opposed to Mr. Navellier, did not subsequently bring an action for damages against the directors.[39]

C. Lessons to Be Learned

These recent cases demonstrate the importance of having proper insurance coverage in place well before a dispute arises. Once hostilities begin, an adviser may take any steps possible to attempt to discourage the independent directors from continuing to challenge or

[38] Yacktman received 21,349,079 votes, which constituted 51.2% of the shares eligible to vote. Removal of the independent directors required a majority of the shares eligible to vote.

[39] *See*, Paul H. Dykstra and Paulita Pike-Bokhari, "The Yacktman Battle: Manager Bites Watchdogs," The Investment Lawyer (Nov./Dec. 1998) for a historical review of the Yacktman saga.

oppose its activities by applying intense financial pressure and even threatening economic ruin. The adviser has a tactical advantage at that point, since it controls the corporate machinery and operates the fund. Navellier is reported to have either canceled the D&O/E&O policy or let it lapse. The result was that apparently no D&O/E&O coverage was available. In Yacktman, the adviser wrote a letter to the directors threatening that no coverage would be available for future litigation because of the insured versus insured exclusion. When the directors submitted a notice of a claim because of Yacktman's subsequent suit, the insurance company declined coverage, citing, among other provisions, this very exclusion.

Similarly, both of these instances demonstrate that broad, clear and mandatory indemnification and advancement of expenses provisions should be in place. In Navellier the directors have won the damage suit (barring reversal on appeal and retrial with an adverse verdict) and undoubtedly should be entitled to be indemnified under federal and state law. It appears, however, that the directors, without any advancements, had to fund the entire defense of the litigation and are still in a dispute over indemnification. As described above, the independent directors in Yacktman also had difficulty obtaining an advancement for their attorneys' fees.

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ANNEX A

SUMMARY OF STATE LAW ON INDEMNIFICATION

A. Maryland Corporation Law

Maryland, like most states, allows funds to include provisions in their charter to indemnify their directors and provide for the advancement of legal fees. Indemnification provisions in the charter and bylaws, and any indemnification provided, must comply with Section 2-418 of Maryland General Corporation Law (the "MGCL"). Under the MGCL, a "director" is defined to include both current and former directors.

1. Mandatory Indemnification

Maryland law requires a corporation, unless limited by charter, to indemnify directors and officers who have been successful, on the merits or otherwise, in defense of any proceeding against reasonable expenses incurred in connection with the proceeding.[40] In the event that a corporation is legally obligated to indemnify a director and does not, a court can order the fund to indemnify a director for reasonable expenses, including attorneys' fees, that the person incurs in securing the indemnification.

a. Permissible Indemnification

In other situations, Section 2-418(b) sets forth a wide range of conduct for which a corporation may, but is not required to, indemnify a director. The MGCL *allows* a corporation to indemnify a director against judgments, penalties, fines, settlements and reasonable expenses actually incurred by the director, unless it is established that:

- the director acted in bad faith and the act or omission was material to the matter giving rise to the claim;[41]
- the director's actions resulted from active and deliberate dishonesty;

[40] (MGCL), 2-418(d)(1). The indemnification rights apply to any threatened, pending or completed action, suit or proceeding, whether criminal, civil or investigative. MGCL 2-418(a)(6). This broad definition includes both appeals in civil and criminal actions and petitions to review administrative actions, as well as many other types of proceedings in which a director may become involved. A director is entitled to indemnification even if the director avoids liability because of a procedural defense unrelated to the merits, such as the statute of limitations. James J. Hanks, Jr., Maryland Corporation Law 202 (1999).

[41] "Bad Faith" is not defined in 2-418. It is generally considered a state of mind that amounts to either the intent to cause harm to the corporation through receipt of personal benefit or otherwise, or conscious disregard of the infliction of harm on the corporation. *See* MGCL 2-405(1)(a); Hanks at 204-204.1.

- the director actually received an improper personal benefit in money, property or services;
- in the case of a criminal proceeding, the director had reasonable cause to believe that the act or omission was unlawful; or
- the director is adjudged liable to the corporation regarding a claim brought by or in the right of the corporation.[42]

Indemnification must be authorized for a specific proceeding and only after a determination has been made that the director has met the standard of conduct described above. The termination of any proceeding by judgment, order or settlement does not create a presumption that the director did not meet the requisite standard of conduct.[43]

The determination as to the propriety of indemnification and reasonableness of amount may be made by either the board of directors, special legal counsel or the shareholders. (Section 2-418(e)).[44]

b. Advancement of Expenses

Under Maryland law, a fund may pay a director's defense expenses before final disposition of the claim if: (i) the director provides a written undertaking to repay such expenses if it is later determined that the director is not entitled to indemnification; and (ii) the director affirms in writing a good faith belief that the director has met the standard of conduct necessary for the fund to provide indemnity. The undertaking must be an unlimited general obligation, but need not be secured.

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[42] MGCL 2-418(b). Of course, settlement of a claim brought by, or a derivative suit on behalf of, the corporation can be indemnified (provided it is not otherwise prohibited) because the director will not have been adjudged liable to the corporation.

[43] Section 2-418(b)3(ii) provides that a "conviction or plea of *nolo contendere* or its equivalent, or entry of an order of probation prior to judgment, creates a rebuttable presumption that the director did not meet the standard of conduct of 2-418(b)(1)." This limited statutory presumption is unusual among state indemnification statutes. The Model Act is to the contrary.

[44] If the determination is made by the board of directors, it must be made "by a majority note of a quorum consisting of directors, not, at the time, parties to the proceeding." If such a quorum cannot be obtained, then a determination must be made 'by a majority vote of a committee of the board consisting of two or more directors not, at the time, parties to such proceeding and who were duly designated to act in the matter by a majority vote of the full board in which the designated directors who are parties may participate . . . .'" MGCL 2-418(e)(2)(i). Thus, even though directors who are parties to the proceeding may not participate in a "determination" by the board, they may participate in the establishment of a committee of independent directors. If the determination is made by "special legal counsel," the counsel is selected either by the board of directors or committee of the board "by a majority vote of a quorum consisting of directors not at the time parties to the proceeding." If a requisite quorum of the full board cannot be obtained and a committee cannot be established, then the selection of special legal counsel must be made "by a majority vote of the full board in which directors who are parties may participate . . . ." MGCL 2-418(e)(2)(ii).

c. Non-Exclusivity

Maryland law also provides that the above-described rights are not exclusive of any other rights to which the directors are entitled under the charter and bylaws, by resolution or agreement. MGCL § 2-418(g). Of course, such resolution or agreement must be consistent with the requirements of the Act. This means that the directors can enter into an indemnification agreement that more precisely sets forth rights to indemnification.

The MGCL also authorizes a corporation to purchase and maintain insurance on behalf of any director, officer, agent or deputy of the corporation against any liability asserted and incurred by such person in such capacity, whether or not the corporation would have the power to indemnify against liability under the provisions of § 2-418. Thus, the corporation may purchase insurance to cover liabilities that it could not indemnify.[45] While D&O insurance often covers claims not covered by state indemnification statutes, as discussed below, D&O policies generally contain exclusions for self-dealing, libel and slander, violations of securities laws, bad faith, willful misconduct and the like.

Section 2-418(k)(2) also authorizes a corporation to provide protection similar to insurance, including a trust fund, letter of credit or surety bond, so long as it is not inconsistent with § 2-418.

B. Massachusetts Business Trusts

Massachusetts business trusts have very broad powers to indemnify directors and officers. Since a Massachusetts business trusts is considered to be a unique and separate type of entity from a corporation, the Massachusetts Business Corporation Law, including its indemnification provisions, does not directly apply to these entities. As a practical matter, their power of indemnification is limited only by the 1940 Act and public policy.

It is helpful, however, to look to Massachusetts law because a court is likely to refer to the statute to resolve questions concerning a business trust.

Massachusetts law[46] provides for broad indemnification authorizing a corporation to make provisions in its charter and bylaws for the indemnification of its directors, officers, employees or other agents, including the payment of expenses incurred in defending a civil or criminal action. The corporation may advance expenses incurred in defending such a proceeding in advance of final disposition, upon receipt of an undertaking by the person indemnified to repay such payment if "adjudicated to be not entitled to indemnification under this section," and no security is required. The only limitation stated is that "no indemnification shall be provided for any person with respect to any matter as to which he shall have been adjudicated in any proceeding not to have acted in good faith in the reasonable belief that his action was in the best interest of the corporation."

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[45] As discussed above, however, the SEC staff believes that Section 17(h) of the 1940 Act prohibits a fund from purchasing insurance to cover liabilities arising out of disabling conduct.

[46] Mass. General Corporation Law 156B 67.

Similar to the law in Maryland, Massachusetts law also authorizes a corporation to purchase and maintain insurance on behalf of directors and officers, whether or not the corporation would have the power to indemnify the director against such liability.

Based upon both Massachusetts law and the 1940 Act, it is likely that courts would permit indemnification and advancement of expenses for directors of a Massachusetts business trust, so long as the provisions of the 1940 Act were satisfied, and provided no bad faith was involved.

C. Delaware Statutory Trusts

The Delaware Statutory Trust Act explicitly provides for broad indemnification of trustees. It states that:

- subject to any standards and restrictions set forth in its governing instrument, a statutory trust shall have the power to indemnify and hold harmless any trustee, beneficial owner or other person from any and all claims and demands whatsoever.

- the absence of an indemnity provision in the trust's governing instrument shall not deprive the trustee, beneficial owner or other person of any right to indemnify that is otherwise available to such person under the law.[47]

It also appears that advancement is permissible, even though the statute does not provide for it explicitly. In the only court decision that construes this statute, the Delaware Chancery Court held that advancement was permissible despite the fact that the statute did not explicitly provide for it.[48] In its analysis, the court noted that the Statutory Trust Act (formerly the Business Trust Act) was intended to be more flexible than the Corporation Act. The court cited the Statutory Trust Act's provision which states that: "it is the Act's policy to give maximum effect to the principles of freedom of contract and to the enforceability of governing instruments."[49]

[47] Del Statutory Trust Act, 3817.

[48] Nakahara v. NS 1991 American Trust, 1998 WL 1055001 (Del. Ch. 1998).

[49] Del. Statutory Trust Act 3823(b).

ANNEX B

SAMPLE FORM OF INDEMNIFICATION AGREEMENT
(Maryland Corporation)

INDEMNIFICATION AGREEMENT

This AGREEMENT is entered into as of _____, ____ ("Agreement"), by and between each of the investment companies set forth on Exhibit A, each of which is a Maryland corporation (individually and collectively, "Company"), and the undersigned director ("Indemnitee").

RECITALS

WHEREAS, it is essential to Company to retain and attract as directors the most capable persons available; and

WHEREAS, through its Articles of Incorporation and Bylaws, it is the express policy of Company to indemnify its directors to the fullest extent permitted by law; and

WHEREAS, the vagaries of amendments to and/or interpretations of legal doctrines, statutes, corporate charters, bylaws, and the Articles of Incorporation and Bylaws of Company, make uncertain the indemnification provided to Director; and

WHEREAS, the Board of Directors of Company ("Board of Directors") has concluded that such uncertainty and the continuation of present trends in litigation against corporate directors and officers inevitably will result in less effective direction and supervision of Company's business affairs, and deems such consequences to be so detrimental to the best interests of Company that it is not only reasonable and prudent but necessary for Company contractually to obligate itself to indemnify in a reasonable and adequate manner its directors and officers, and to establish procedures and presumptions with respect thereto to make the process of indemnification more timely, efficient and certain; and

WHEREAS, the Maryland General Corporation Law, under which the Company is organized, in Section 2-418 thereof empowers corporations to indemnify, among others, any person serving as a director of the company, and specifies that the indemnification set forth therein shall not be deemed exclusive of any other rights, by indemnification or otherwise, to which those seeking indemnification may be entitled under the charter, bylaws, resolution of stockholders or directors, an agreement or otherwise; and

WHEREAS, Company desires to have Indemnitee serve or continue to serve as a director for the convenience of or to represent the interests of Company free from undue concern for unpredictable, inappropriate or unreasonable claims for damages and related costs and expenses by reason of Indemnitee's Corporate Status (as defined below), and Indemnitee desires to serve or to continue to serve as a director or other Corporate Status provided that Indemnitee is furnished the indemnity and other rights provided for hereinafter;

NOW, THEREFORE, in consideration of the premises and the covenants contained herein, and for other good and valuable consideration, the receipt and sufficiency of which the parties hereby acknowledge, Company and Indemnitee do hereby covenant and agree as follows:

Section 1. Definitions. For purposes of this Agreement:

(a) "Change in Control" means: (i) a change in the membership of the Board of Directors during any period of time following the date of this Agreement, such that individuals who, at the beginning of any such period, constitute the directors, cease for any reason to constitute at least a majority thereof, unless the election of new directors, or their nomination for election by Company's stockholders, is approved by a vote of at least two-thirds of such directors of Company then still in office who were directors of Company at the beginning of any such period; (ii) the acquisition of Company by another entity, or the merger of Company into another entity, such that Company is not the surviving entity, or the consolidation of Company with another entity, or the acquisition of substantially all of the assets of Company by another entity; and/or (iii) the appointment of a receiver, conservator, trustee, liquidator, rehabilitator, or any similar official for or with respect to Company. Notwithstanding and without limiting the foregoing, a "change of control" shall include a change in the membership of the Board of Directors that is opposed by a majority of the then-current directors of Company who are not "interested persons" of Company, as that term is defined by Section 2(a)(19) of the Investment Company Act of 1940, or who are "interested persons" solely by reason of being an officer of Company.

(b) "Corporate Status" means the status as a director, officer, employee or authorized agent of Company of a person who is or was a director, officer, employee or authorized agent of Company.

(c) "Disabling Conduct" means (i) a final adjudication that an act or omission of Indemnitee, in the performance of Indemnitee's duties as a director or officer of Company that gave rise to the claims, issues or matters asserted against Indemnitee in a Proceeding, was committed in bad faith or was the result of active or deliberate dishonesty, or that Indemnitee actually received an improper benefit in money, property or services, or in the case of a criminal proceeding, that Indemnitee had reasonable cause to believe that the act or omission was unlawful; or (ii) with respect to any liability of Indemnitee to Company or its security holders, a final adjudication, or other determination in accordance with Sections 5(b) and 6 hereof, that Indemnitee, in the performance of Indemnitee's duties as a director or officer of Company that gave rise to the claims, issues or matters asserted against Indemnitee in a Proceeding, engaged in willful misfeasance, bad faith, gross negligence or reckless disregard of Indemnitee's duties as a director and/or officer of Company.

(d) "Disinterested Director" means a director of Company (i) who is not and was not a party to the Proceeding in respect of which indemnification or advancement of Expenses is sought by Indemnitee, and (ii) who is not an "interested person" of Company as that term is defined by Section 2(a)(19) of the Investment Company Act of 1940, or who is an "interested person" solely by reason of being an officer of Company.

(e) "Expenses" means all reasonable attorneys' fees and disbursements, retainers, court costs, transcript costs, fees and expenses of experts, witness fees and expenses, travel expenses, duplicating costs, computerized legal research costs, printing and binding costs, telephone, facsimile and other technology charges, postage, delivery service fees, and all other disbursements or expenses of the types customarily incurred in connection with prosecuting, defending or investigating, or preparing to prosecute, defend or investigate, or being or preparing to be a witness in, a Proceeding.

(f) "Indemnified Parties" means Indemnitee's spouse, Indemnitee's heirs, the executors, administrators and other legal representatives of Indemnitee's estate, the beneficiaries of Indemnitee's estate, including without limitation any trust created by will, and the trustees and beneficiaries thereof, and any other trust as to which Indemnitee is a grantor or beneficiary, and the trustees and beneficiaries thereof.

(g) "Independent Counsel" means an attorney who, or a law firm the attorneys of which, is selected or appointed in accordance with Section 5(c) hereof and which: (i) at the time of selection and within two (2) years prior to that time is not and has not served as Independent Counsel pursuant to the terms of this Agreement, or any similar Agreement between Company and a director or officer of Company, with respect to a Proceeding other than the Proceeding with respect to which Indemnitee seeks indemnification or advancement of Expenses; (ii) has experience in matters of corporate governance and investment company law; (iii) at the time of selection as Independent Counsel and within two (2) years prior to that time, is not and has not represented Company, Indemnitee, or any other party to the Proceeding with respect to which Indemnitee seeks indemnification or advancement of Expenses, in or with respect to any legal matter; and (iv) confirms in writing that the attorney or law firm satisfies the above criteria and is aware of no conflict of interest or other prohibition under the applicable standards of professional conduct prevailing at that time that would result from or apply to the attorney's or law firm's service as Independent Counsel with respect to such Proceeding.

(h) "MGCL" means the Maryland General Corporation Law.

(i) "Proceeding" means any threatened, pending or completed action, suit, arbitration, alternate dispute resolution mechanism, investigation, administrative or other hearing, or any other proceeding, whether civil, criminal, administrative or investigative, in which Indemnitee now or hereafter is or was a party or is threatened to be made a party or a witness by reason of Indemnitee's Corporate Status.

Section 2. Service by Indemnitee. Indemnitee agrees to serve and/or continue to serve Company as a director or in other Corporate Status; provided however, Indemnitee may at any time and for any reason resign from such position (subject to any other obligation under contract or by operation of law), and Company shall have no obligation under this Agreement to continue Indemnitee in such position for any period of time; provided further, following termination of Indemnitee's service to Company in a Corporate Status at any time and for any reason, whether with or without cause, Indemnitee and the Indemnified Parties shall be entitled to all of the rights and benefits provided hereunder. Company acknowledges and agrees that it has entered into this Agreement and assumed the obligations imposed on Company hereunder in order to induce Indemnitee to serve and to continue to serve Company as a director or in other

Corporate Status, and acknowledges that Indemnitee is relying upon this Agreement in continuing to serve in such position.

Section 3. Indemnification.

(a) Company shall indemnify, and advance Expenses to, Indemnitee (i) as specifically provided in this Agreement and (ii) otherwise to the fullest extent permitted by applicable law in effect on the date hereof and/or as amended from time to time; provided, however, no change in applicable law shall have the effect of reducing the rights and benefits available to Indemnitee hereunder based on applicable law as in effect on the date hereof. The rights of Indemnitee provided in this Section 3 shall include, but shall not be limited to, the rights set forth in the other Sections of this Agreement; provided however, Indemnitee shall be entitled to indemnification and advancement of Expenses hereunder with respect to a Proceeding only if at the time of the request therefore, Indemnitee is not an "interested person" of Company as that term is defined in Section 2(a)(19) of the Investment Company Act of 1940, or is an "interested person" solely by reason of being an officer of Company.

(b) Indemnitee shall be entitled to the rights of indemnification provided in this Section 3(b) if Indemnitee is or is threatened to be made a party to a Proceeding other than a Proceeding by or in the right of Company. In accordance with this Section 3(b), Company shall indemnify Indemnitee for and against any and all judgments, penalties, fines and amounts paid in settlement, and all Expenses actually and reasonably incurred by Indemnitee or on Indemnitee's behalf in connection with a Proceeding, to the maximum extent permitted by Maryland law and to the extent not expressly prohibited by applicable federal securities law and regulations (including without limitation Section 17(h) of the Investment Company Act, and regulations or rules issued with respect thereto by the U.S. Securities Exchange Commission), in effect as of the date of this Agreement or at the time of the request for indemnification, whichever affords greater rights of indemnification to Indemnitee, including any additional indemnification permitted by Section 2-418(g) of the MGCL.

(c) Indemnitee shall be entitled to the rights of indemnification provided in this Section 3(c) if Indemnitee is or is threatened to be made a party to any Proceeding brought by or in the right of Company to procure a judgment in its favor. In accordance with this Section 3(c), Company shall indemnify Indemnitee for and against any and all judgments, penalties, fines and amounts paid in settlement, and all Expenses actually and reasonably incurred by Indemnitee or on Indemnitee's behalf in connection with a Proceeding brought by or in the right of Company to procure a judgment in its favor, to the maximum extent permitted by Maryland law and to the extent not expressly prohibited by applicable federal securities law and regulations (including without limitation Section 17(h) of the Investment Company Act, and regulations or rules issued with respect thereto by the U.S. Securities Exchange Commission), in effect as of the date of this Agreement or at the time of the request for indemnification, whichever affords greater rights of indemnification to Indemnitee, including any additional indemnification permitted by Section 2-418(g) of the MGCL.

(d) Notwithstanding any other provision of this Agreement to the contrary, Company shall indemnify Indemnitee for and against any and all judgments, penalties, fines and amounts paid in settlement, and all Expenses actually and reasonably incurred by or on behalf of

Indemnitee in connection with any Proceeding to which Indemnitee is made a party and with respect to which Indemnitee is successful, in whole or in part, on the merits or otherwise, in a final determination or result; provided however, if Indemnitee is successful on the merits or otherwise, as to one or more but less than all claims, issues or matters in such Proceeding, Company shall indemnify Indemnitee against any and all judgments, penalties, fines and amounts paid in settlement, and all Expenses actually and reasonably incurred by or on behalf of Indemnitee in connection with each successfully resolved claim, issue or matter in the Proceeding. For purposes of this Section 3 and without limitation, the termination of any claim, issue or matter in such a Proceeding in favor of Indemnitee (i) by dismissal, summary judgment, judgment on the pleadings, or final judgment, with or without prejudice, or (ii) by agreement without any payment or assumption or admission of liability by Indemnitee, shall be deemed a successful determination or result with respect thereto.

(e) Notwithstanding any other provision of this Agreement to the contrary, Company shall indemnify Indemnitee for and against all Expenses actually and reasonably incurred by Indemnitee or on Indemnitee's behalf in connection with any Proceeding to which Indemnitee is or is threatened to be made a witness but not a party, within fifteen (15) days after receipt by Company of each statement of Expenses from Indemnitee with respect thereto.

(f) Notwithstanding any other provision of this Agreement to the contrary, Company shall not be liable for indemnification hereunder in connection with: (i) any monetary settlement by or judgment against Indemnitee for insider trading or disgorgement of profits by Indemnitee pursuant to Section 16(b) of the Securities Exchange Act of 1934; or (ii) any liability to Company or its stockholders with respect to a Proceeding (other than a proceeding under Section 7(a) hereof), to which Indemnitee otherwise would be subject by reason of Disabling Conduct by Indemnitee.

Section 4. Advancement of Expenses.

(a) Indemnitee shall be entitled to the rights of advancement of Expenses provided in this Section 4(a) if Indemnitee is or is threatened to be made a party to or a witness in a Proceeding. In accordance with this Section 4(a), Company shall advance all Expenses incurred by or on behalf of Indemnitee in connection with any Proceeding to which Indemnitee is or is threatened to be made a party or a witness, to the maximum extent permitted by Maryland law and to the extent not expressly prohibited by applicable federal securities law and regulations (including without limitation Section 17(h) of the Investment Company Act, and regulations or rules issued with respect thereto by the U.S. Securities Exchange Commission), in effect as of the date of this Agreement or at the time of a request for advancement of Expenses, whichever affords greater rights of advancement of Expenses to Indemnitee, including any additional right to advancement of Expenses permitted by Section 2-418(g) of the MGCL.

(b) To receive advancement of Expenses in accordance with Section 4(a) hereof, Indemnitee, at any time prior to, during or following termination of a Proceeding, shall submit to the Secretary of Company a notice and statement of Expenses, which: (i) shall reasonably evidence the Expenses incurred by or on behalf of Indemnitee in connection with the Proceeding; (ii) shall include or be preceded or accompanied by a written affirmation of Indemnitee's good faith belief that Indemnitee's conduct that gave rise to the claims, issues or

matters asserted against Indemnitee in the Proceeding meets the standard of conduct necessary for indemnification by Company in accordance with Sections 3, 5 and 6 hereof, and a written undertaking by or on behalf of Indemnitee to repay any Expenses advanced if it shall ultimately be determined that Indemnitee is not entitled to indemnification hereunder or, as described in Section 3(d) hereof, if Indemnitee is not wholly successful; and (iii) shall specify whether any determination with respect thereto that may be made in accordance with Sections 4(c) and (d) hereof shall be made by the Board of Directors or by Independent Counsel. The Secretary of Company, promptly upon receipt of a notice and statement of Expenses, shall advise the Board of Directors in writing that Indemnitee has requested advancement of Expenses.

(c) Indemnitee shall be entitled to advancement of Expenses in connection with a Proceeding in accordance with Sections 4(a) and (b) hereof only if: (i) Company is insured against losses arising by reason of Company's lawful advancement of such Expenses (in which event the remaining provisions of this Sections 4(c) shall not apply with respect thereto); or (ii) Indemnitee gives adequate security to Company for the undertaking to repay such amounts; or (iii) a determination is made that there is a basis for a reasonable belief that Indemnitee ultimately will be found entitled to indemnification for and with respect to the Proceeding, or the claims, issues or matters with respect thereto for which Indemnitee seeks advancement of Expenses.

(d) A determination in accordance with Section 4(c)(iii) hereof shall be made in accordance with the standards and presumptions in Sections 3 and 6 hereof, in a resolution adopted by a majority of a quorum of the Board of Directors consisting of Disinterested Directors or, at Indemnitee's option, by Independent Counsel selected or appointed in accordance with Section 5(c) hereof, in a written opinion submitted to the Board of Directors, a copy of which shall be delivered to Indemnitee.

(e) If Indemnitee is entitled to advancement of Expenses in accordance with Sections 4(a) through (d) hereof, Company shall pay or reimburse Indemnitee for all Expenses for which a notice and statement of Expenses is submitted in accordance with Section 4(b) hereof, within fifteen (15) days (i) after receipt by Company of the notice and statement of Expenses, if Section 4(c)(i) applies thereto, (ii) after Indemnitee gives adequate security to Company for the undertaking to repay such amounts, if Section 4(c)(ii) applies thereto, or (iii) after a determination is made in accordance with Section 4(c)(iii), if that Section applies thereto.

Section 5. Indemnification Procedure; Payment; Cooperation.

(a) To obtain indemnification hereunder, Indemnitee shall submit a notice to the Secretary of Company that identifies the Proceeding and/or the claims, issues or matters with respect thereto for which indemnification is sought, and that specifies whether any determination with respect thereto that may be made in accordance with Section 5(b) hereof shall be made by the Board of Directors or Independent Counsel. The Secretary of Company, promptly upon receipt of such a request for indemnification, shall advise the Board of Directors in writing that Indemnitee has requested indemnification.

(b) Upon submission of a notice by Indemnitee in accordance with Section 5(a) hereof, a determination of Indemnitee's entitlement to indemnification shall be made as follows:

(1) Indemnitee shall be entitled to indemnification hereunder without a separate determination by or on behalf of Company, with respect to any Proceeding and/or any claim, issue or matter with respect thereto: (i) which is resolved by agreement without any payment or assumption or admission of liability by Indemnitee; or (ii) as to which a final decision on the merits has been made by the court or other body with jurisdiction over the Proceeding, in which Indemnitee was not determined to be liable with respect to such claim, issue or matter asserted against Indemnitee in the Proceeding or was not determined to have engaged in any Disabling Conduct that gave rise to any such liability or in which no other controlling standard was shown to apply that would prohibit Company under applicable law from providing indemnification under the standards and presumptions in Sections 3 and 6 hereof; or (iii) as to which a court or arbitrator determines upon application that, despite such a determination of liability on the part of Indemnitee, but in view of all the circumstances of the Proceeding and of Indemnitee's conduct in a Corporate Status with respect thereto, Indemnitee is fairly and reasonably entitled to indemnification for such judgments, penalties, fines, amounts paid in settlement and Expenses as such court or arbitrator shall deem proper; provided however, such decision shall have been rendered in or with respect to the Proceeding for which the Indemnitee seeks indemnification under this Agreement.

(2) if Section 5(b)(1) hereof does not apply and a Change in Control shall have occurred, Indemnitee shall be entitled to indemnification unless a reasonable determination is made, in accordance with the standards and presumptions in Sections 3 and 6 hereof, that Company is prohibited by applicable law from providing the requested indemnification. The determination shall be made, at Indemnitee's sole option, either: (i) by the Board of Directors in a resolution adopted in accordance with Section 5(b)(3) hereof; or (ii) by Independent Counsel in a written opinion submitted to the Board of Directors, a copy of which shall be delivered to Indemnitee.

(3) if Section 5(b)(1) hereof does not apply and a Change of Control has not occurred, Indemnitee shall be entitled to indemnification unless a reasonable determination is made, in accordance with the standards and presumptions in Sections 3 and 6 hereof, that Company is prohibited by applicable law from providing the requested indemnification. The determination shall be made either in a resolution adopted by the vote of a majority of a quorum of the Board of Directors consisting of Disinterested Directors or, if such a quorum is not obtainable or even if obtainable but such a quorum so directs, by Independent Counsel in a written opinion to the Board of Directors, a copy of which shall be delivered to Indemnitee; provided however, Company shall provide notice to Indemnitee within thirty (30) days following receipt of notice from Indemnitee in accordance with Section 5(a) hereof, if the Board of Trustees directs that such determination shall be made by Independent Counsel.

(c) Independent Counsel shall be selected to make a determination of Indemnitee's entitlement to indemnification or advancement of Expenses as follows:

(1) Indemnitee initially may select one or more but not more than five alternate attorneys or law firms who satisfy the criteria in Section 1(g) hereof, by providing notice of such selection, together with the written confirmation provided for in Section 1(g)(iv) hereof, for each such attorney or law firm, to the Secretary of Company, who shall promptly deliver copies of the notice to all members of the Board of Directors.

(2) Company, by a vote of a majority of a quorum of the Board of Directors consisting of Disinterested Directors (or, if such a quorum cannot be obtained, then by a majority vote of a committee of the Board of Directors consisting solely of two or more directors who are not at the time parties to the Proceeding and who were duly designated to act in the matter by a majority vote of a quorum of the Board of Directors, in which directors who are parties to the Proceeding may participate; or, if such a committee cannot be designated, then by a majority vote of a quorum of the Board of Directors, in which directors who are parties to the Proceeding may participate), may reject one or more of the attorneys or law firms selected by Indemnitee for cause, which shall be limited to a showing by Company that such attorney or law firm fails to satisfy one or more of the criteria in Section 1(g) hereof; provided however, Company may reject for cause a law firm (or an attorney associated therewith) that has an AV rating by Martindale Hubbell Law Directory and fifty (50) or more attorneys, only on the basis that Company has shown that the attorney or law firm fails to satisfy the criteria in Section 1(g)(i), (iii) or (iv) hereof.

(3) Company shall provide notice to Indemnitee, within thirty (30) days following receipt of Indemnitee's notice of selection in accordance with Section 5(c)(1) hereof, stating as to each attorney or law firm listed therein either that Company does not object or that Company rejects such selection for cause in accordance with Section 5(c)(2) hereof, and stating the grounds therefore and providing a copy of the resolution of the Board of Directors evidencing such rejection. Company will be deemed not to object to any attorney or law firm initially selected by Indemnitee as to whom Company does not provide timely notice of rejection in accordance herewith.

(4) In the event Company, in accordance with Sections 5(c)(2) and (3) hereof, timely rejects for cause each of the attorneys or law firms initially selected by Indemnitee: (i) Indemnitee may select one or more but no more than five additional alternate attorneys or law firms in accordance with Section 5(c)(1) hereof, which selection shall be subject to Company's right of rejection for cause in accordance with Section 5(c)(2) hereof.

(5) Upon receipt of notice that Company does not object to one or more attorneys or law firms initially selected by Indemnitee in accordance with Sections 5(c)(1) through (4) hereof, Indemnitee shall confirm the selection of one such attorney or law firm as Independent Counsel in a notice to the Secretary of Company.

(6) In the event a final selection of Independent Counsel has not occurred in accordance with Sections 5(c)(1) through (5) hereof, and upon receipt of a demand in a notice from Indemnitee, Company shall immediately institute an action in an appropriate court of the State of Maryland with jurisdiction over the matter, naming Indemnitee as a party thereto, and shall petition said court to appoint as Independent Counsel an attorney or law firm who satisfies the criteria in Section 1(g) hereof, giving preference to the greatest extent possible to

attorneys or law firms initially selected by Indemnitee in accordance with this Section 5(c), which selection shall be binding on Indemnitee and Company. In any such court action, Company shall take all necessary steps to expedite a determination by the court, and shall have the burden of proof and persuasion to show, by clear and convincing evidence, that rejection for cause in accordance with Section 5(c)(2) hereof is warranted as to each of the attorneys or law firms initially selected by Indemnitee. Company shall pay all attorneys' fees, costs and expenses incurred by Company and/or by Indemnitee in connection with any such court action.

(d) Upon the selection or appointment of Independent Counsel in accordance with Section 5(c) hereof, Company: (i) shall execute such retention agreement as Independent Counsel reasonably may require, including without limitation any such agreement that obligates Company to indemnify and hold harmless Independent Counsel with respect to services provided in that capacity; and (ii) shall pay all retainers, fees and expenses charged by Independent Counsel for or in connection with services provided in that capacity, within ten (10) days following receipt of an itemized statement for same; provided however, Independent Counsel shall not be deemed to be disqualified from serving as such by virtue of Company's compliance with this provision.

(e) Indemnitee and Company shall cooperate with the person(s) making a determination of Indemnitee's entitlement to indemnification, including providing to such person(s) upon any reasonable advance request, any documentation or information that is not privileged and which is reasonably available to Indemnitee or Company and reasonably necessary to such determination; provided however, any and all documents or information provided in response to such request that are deemed confidential by the submitting party shall be held and used by the recipient on a confidential basis, and shall not be disclosed other than to Company or Indemnitee or used for any purpose other than to make such determination, except by order of court or in response to a subpoena or other compulsory process; provided further the failure of Indemnitee to provide such assistance shall not limit or otherwise affect Indemnitee's right to indemnification or advancement or payment of Expenses hereunder in connection with a specific Proceeding unless, and only to the extent, such failure is shown by Company to have caused actual prejudice to Company with respect thereto. Any costs or expenses (including reasonable attorneys' fees and disbursements) incurred by Indemnitee in so cooperating with the person(s) making such determination shall be paid directly by or reimbursed by Company, irrespective of the determination as to Indemnitee's entitlement to indemnification.

(f) If Indemnitee is determined to be entitled to indemnification in accordance with Section 5(b) hereof, Company, within thirty (30) days after such determination: (i) shall pay all judgments, penalties, fines, amounts paid in settlement and Expenses for which Indemnitee seeks indemnification and which have not already been paid or advanced by Company; (ii) shall provide Indemnitee with written evidence of satisfaction of such obligations; and (iii) shall issue a written release to Indemnitee with respect to any undertaking previously provided by Indemnitee in accordance with Section 4(b) hereof to repay Expenses advanced by Company. Company shall pay any and all additional amounts for which Indemnitee is entitled to indemnification within thirty (30) days after such amounts become due and payable.

Section 6. Presumptions and Effect of Certain Proceedings.

(a) Any person(s) making a determination of whether Indemnitee is entitled to indemnification or advancement of Expenses hereunder: (i) shall do so based on a rebuttable presumption that Indemnitee is entitled to indemnification or advancement of Expenses hereunder, that Indemnitee has not engaged in Disabling Conduct, that Indemnitee's actions in a Corporate Status were based on Indemnitee's determination that those actions were in the best interests of Company, and that no other controlling standard applies that would prohibit Company under applicable law from providing indemnification or advancement of Expenses under the standard in Sections 3 or 4 hereof; and (ii) shall require that, to overcome such presumption and to make any contrary determination, Company shall bear the burden of proof and persuasion to show, by clear and convincing evidence, that Company is prohibited by applicable law from providing indemnification or advancement of Expenses under the standard in Sections 3 or 4 hereof, either due to Disabling Conduct that gave rise to the claim, issue or matter for which indemnification or advancement of Expenses is sought and which is asserted against Indemnitee in the Proceeding, or based on application of another controlling standard that is recognized by applicable law and which is shown to apply with respect to the request for indemnification or advancement of Expenses.

(b) In the event the Board of Directors is required to make a determination of Indemnitee's entitlement to indemnification or advancement of Expenses in accordance with Sections 4(d), 5(c)(2) or 5(c)(3) hereof, but does not provide notice to Indemnitee of such determination within the later of (i) forty-five (45) days after receipt by Company of Indemnitee's notice in accordance with Sections 4(b) and/or 5(a) hereof, or (ii) with respect to a request for indemnification, thirty (30) days after Indemnitee substantially complies with a request for information in accordance with Section 5(e) hereof, Indemnitee shall be deemed to be entitled to such indemnification or advancement of Expenses, absent a prohibition under applicable law against providing indemnification or advancement of Expenses on this basis.

(c) Except as otherwise expressly provided in this Agreement, the termination of any Proceeding, or of any claim, issue or matter related thereto, by judgment, order, settlement or conviction, or upon a plea of nolo contendere or its equivalent, shall not be deemed a sufficient ground (i) to deny a request for indemnification or advancement of Expenses submitted in accordance with this Agreement, or (ii) to create a presumption that Indemnitee engaged in Disabling Conduct or is not entitled to indemnification or advancement of Expenses based on application of another controlling standard which is recognized by applicable law, or, with respect to any criminal Proceeding, that Indemnitee had reasonable cause to believe that Indemnitee's conduct was unlawful.

Section 7. Remedies of Indemnitee.

(a) Indemnitee may institute an action in an appropriate court of The State of Maryland, or in any other court of competent jurisdiction, to enforce Indemnitee's rights to indemnification or payment or advancement of Expenses hereunder, and/or to obtain a declaration of Indemnitee's entitlement to indemnification or advancement of Expenses hereunder, upon the happening of any one or more of the following events: (i) a determination is made in accordance with Section 5 hereof that Indemnitee is not entitled to indemnification;

(ii) a determination is made in accordance with Section 4 hereof that Indemnitee is not entitled to advancement of Expenses, or advancement of Expenses is not made within the time provided therein; (iii) payment of indemnification is not made in accordance with Sections 5(f) and/or 6(b) hereof within the time provided therein; (iv) payment of indemnification is not made in accordance with Section 3(e) hereof within the time provided therein; or (v) at any other time that Indemnitee is threatened by a loss of any right hereunder, or by Company's failure to perform its obligations in accordance herewith. Alternatively, Indemnitee, at Indemnitee's sole option, may seek an award in arbitration to enforce such rights and/or obtain such a declaration, which shall be conducted by a single arbitrator in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a location selected by Indemnitee (or, if Indemnitee makes no selection, at a location determined in accordance with such rules).

(b) If a determination shall have been made in accordance with Section 4 hereof that Indemnitee is not entitled to advancement of Expenses, or in accordance with Section 5 hereof that Indemnitee is not entitled to indemnification, any judicial or arbitration proceeding commenced in accordance with this Section 7 shall be conducted in all respects as a de novo trial or arbitration on the merits, and such adverse determination shall not be introduced as evidence or otherwise used in said proceeding as a basis for ruling on the merits of Indemnitee's right to indemnification or advancement of Expenses.

(c) If a determination has been made or deemed to have been made in accordance with Sections 4, 5 and 6 hereof that Indemnitee is entitled to indemnification or advancement of Expenses, Company shall be bound by such determination in any judicial or arbitration proceeding commenced in accordance with this Section 7, unless the court or arbitrator rules that entry of an order requiring indemnification or advancement of Expenses on the basis of this provision is prohibited by Maryland law or by applicable federal securities law or regulations in effect at the date of this Agreement or at the time of such ruling, whichever affords greater rights of indemnification or advancement of Expenses to Indemnitee.

(d) Company shall be precluded from asserting in any judicial or arbitration proceeding commenced in accordance with this Section 7 that the procedures and presumptions of this Agreement are not valid, binding and enforceable, and shall stipulate in any such proceeding that Company is bound by all the provisions of this Agreement.

(e) If Indemnitee institutes a judicial or arbitration proceeding to enforce or declare Indemnitee's rights under, or to recover damages for breach of, this Agreement, Indemnitee shall be entitled to recover from Company, and shall be indemnified by Company against, any and all Expenses actually and reasonably incurred by Indemnitee in such proceeding (including any appeal therefrom or other court proceeding to enforce an arbitrator's ruling and award), but only if Indemnitee substantially prevails therein; provided however, if it is determined in such a proceeding that Indemnitee is entitled to receive part but not all of the indemnification or advancement of Expenses sought, Company shall pay a portion of the Expenses incurred by Indemnitee in connection with such proceeding, prorated based on the percentage of Expenses awarded to Indemnitee, or the percentage of claims, issues or matters as to which indemnification or advancement of Expenses is awarded to Indemnitee, whichever is more favorable to Indemnitee.

(f) Company shall pay or reimburse Indemnitee for all Expenses to which Indemnitee is entitled in accordance with Section 7(e) hereof (including all such Expenses incurred in connection with any appeal therefrom or other court proceeding to enforce an arbitrator's ruling and award), within fifteen (15) days following the later of (i) entry of a final judgment by the trial court or a final ruling by the arbitrator or (ii) receipt by Company of each notice and statement of Expense with respect thereto; provided however, any such payment of Expenses shall be subject to Indemnitee's written undertaking in accordance with Section 4(b) hereof to repay any Expenses advanced if it shall ultimately be determined that Indemnitee is not entitled to indemnification hereunder or, as described in Section 3(d) hereof, if Indemnitee is not wholly successful.

Section 8. Non-Exclusivity; Insurance; Subrogation.

(a) Indemnitee's rights of indemnification and advancement of Expenses hereunder shall not be deemed exclusive of any other rights to which Indemnitee may at any time be entitled under applicable law, the Articles of Incorporation and Bylaws of Company, any other agreement, any insurance policy, a vote of stockholders, a resolution of the Board of Directors, or otherwise. No amendment, alteration or repeal of this Agreement or of any provision hereof shall limit or restrict any right of Indemnitee hereunder with respect to any action taken or omitted by Indemnitee in a Corporate Status prior to such amendment, alteration or repeal.

(b) To the extent that Company maintains liability insurance for directors, officers, employees or agents of Company, Indemnitee shall be covered by such policy or policies in accordance with its or their terms, to the maximum extent of the coverage available (including coverage after Indemnitee is no longer serving in a Corporate Status for acts and omissions while serving in a Corporate Status), for any such director, officer, employee or agent under such policy or policies.

(c) In the event of any payment under this Agreement, Company shall be subrogated to the extent of such payment to all of the rights of recovery of Indemnitee, who shall execute all papers required and take all action necessary to secure such rights, including execution of such documents as are necessary to enable Company to bring suit to enforce such rights.

Section 9. Duration of Agreement. All agreements and obligations of Company as provided in this Agreement shall continue during the period Indemnitee serves in a Corporate Status, and thereafter for such time as Indemnitee is, may be or is threatened to be made a party to or a witness in a Proceeding, or a judicial or arbitration proceeding commenced by Indemnitee in accordance with Section 7 hereof.

Section 10. Binding Effect; Assumption of Liability; Limitation of Actions and Release of Claims.

(a) This Agreement shall be binding upon Company and its successors and assigns, shall continue as to Indemnitee after termination of Indemnitee's service to Company in

a Corporate Status, and shall inure to the benefit of Indemnitee and any and all Indemnified Parties.

(b) If Indemnitee is deceased and is entitled to any right of indemnification or advancement or payment of Expenses under this Agreement with respect to a Proceeding, Company shall indemnify any and all Indemnified Parties, for and against any and all judgments, penalties, fines, amounts paid in settlement and Expenses incurred by Indemnitee or for which Indemnitee is or may be liable, and Company shall and hereby agrees to assume and to pay any and all Expenses actually and reasonably incurred by Indemnitee or any Indemnified Party, or otherwise on Indemnitee's behalf, in connection with the Proceeding. When requested in writing by an Indemnified Party, Company shall provide written evidence and acknowledgement of Company's agreement and obligations hereunder.

(c) No legal action shall be brought and no claim or cause of action shall be asserted by or on behalf of Company against Indemnitee or any Indemnified Party based upon or arising out of any right of Company or any obligation of Indemnitee under this Agreement, after the later of one (1) year following (i) the date of termination of Indemnitee's service to Company in a Corporate Status, or (ii) with respect to a particular Proceeding in connection with which Indemnitee requests indemnification or advancement of Expenses hereunder, the final termination of such Proceeding, and any such claim or cause of action of Company shall be extinguished and deemed released unless asserted by filing a legal action within such time.

Section 11. Severability. If any provision(s) of this Agreement shall be held to be invalid, illegal or unenforceable for any reason whatsoever: (a) the validity, legality and enforceability of the remaining provisions of this Agreement (including, without limitation, each other provision of any Section of this Agreement containing a provision(s) held to be invalid, illegal or unenforceable, that is not itself invalid, illegal or unenforceable) shall not in any way be affected or impaired thereby; and (b) to the fullest extent possible, the provisions of this Agreement (including, without limitation, each other provision of any Section of this Agreement containing a provision(s) held to be invalid, illegal or unenforceable, that is not itself invalid, illegal or unenforceable) shall be construed so as to give effect to the intent manifested thereby.

Section 12. Assignment. Indemnitee, in Indemnitee's sole discretion, may assign Indemnitee's rights under this Agreement to a third party. This Agreement shall be binding upon Company and its successors, and may be assigned by Company only with Indemnitee's written consent which may be withheld for any reason.

Section 13. Counterparts. This Agreement may be executed in one or more counterparts, each of which shall be deemed to be an original for all purposes but all of which together shall constitute one and the same Agreement. Only one such counterpart signed by the party against whom enforceability is sought needs to be produced to evidence the existence of this Agreement. The parties agree to accept copies of the executed originals of this Agreement, and of any notice provided in accordance herewith, as and in place of such originals.

Section 14. Headings and Recitals. The headings of the Sections of this Agreement are inserted for convenience only and shall not be deemed to constitute part of this Agreement or

to affect the construction thereof. The Recitals set forth above shall be construed as substantive in nature, and are an integral part of this Agreement.

Section 15. Modification and Waiver. No supplement, modification or amendment of this Agreement shall be binding unless in writing executed by both Company and Indemnitee. No waiver of any of the provisions of this Agreement shall be deemed or shall constitute a waiver of any other provisions hereof (whether or not similar), nor shall such waiver constitute a continuing waiver.

Section 16. Notices. All notices, requests, demands and other communications hereunder shall be in writing and shall be deemed to have been duly given if (i) delivered by hand or by courier service and receipted for by or on behalf of the party to whom said notice or other communication shall have been directed, (ii) delivered by facsimile or email, or (iii) mailed by certified or registered mail with postage prepaid, on the third business day after the date on which it is so mailed, as follows:

(a) If to Indemnitee, to the last know address, facsimile number or email address for Indemnitee in the records of Company, and to the address, facsimile number or email address set forth below the signature line for Indemnitee at the end of this Agreement, with a copy to:

(b) If to Company, to the then-current facsimile number or email address for the Secretary of the Company, or to:

with a copy to:

or to such other address as may have been furnished to Indemnitee by Company, or to Company by Indemnitee, as the case may be, in a notice delivered in accordance with this Section 16.

Section 17. Governing Law. This Agreement shall be governed by and construed and enforced in accordance with the laws of The State of Maryland, without regard to the choice of law or conflicts of law principles thereof.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

INDEMNITEE:

By: _____

Printed Name: _____

Address: _____

_____

Facsimile: _____

E-mail: _____

COMPANIES as listed on Exhibit A hereto:

By: _____

Printed Name:

Title: President

ANNEX C

SAMPLE FORM OF ALLOCATION AGREEMENT

D&O/E&O AGREEMENT

THIS AGREEMENT (the "Agreement") is made as of _____, ____, by and among the investment companies listed as signatories on Schedule A to this Agreement (the "Funds"), each acting on its own behalf and on behalf of its individual Trustees and each portfolio series of the Fund identified from time to time on Schedule A (each, a "Series"), and _____ (the "Adviser"), acting on its own behalf and on behalf of certain of its affiliates identified on Schedule A to this Agreement (individually hereinafter referred to as an "Affiliate" or collectively as "Affiliates") (the Adviser and each Fund sometimes individually hereinafter referred to as a "party" or collectively as "parties").

WHEREAS, the Adviser and certain Affiliates act as investment adviser, transfer agent, administrator and/or underwriter to each of the Funds and may from time to time hereafter act in the same capacity with respect to other investment companies and also supervise the handling and settlement of claims under joint liability insurance policies purchased for the protection of the Adviser and its Affiliates and the Funds;

WHEREAS, the Funds, the Adviser and the Affiliates have been named as Insureds under one or more directors and officers, errors and omissions insurance policies (referred to individually as a "Policy" and collectively as the "Policies"); and

WHEREAS, the parties further desire to establish (i) the criteria by which the premiums for the Policies shall be allocated among the parties, (ii) the basis on which additional investment companies for which the Adviser or its affiliates may hereafter act as investment adviser may be added as named Insureds under the Policies, and (iii) the criteria by which recoveries under the Policies shall be allocated among the parties covered under the same, and (iv) the manner in which the Adviser will report to the Funds' respective Boards information about potential claims, claims and payments under any of the Policies;

NOW, THEREFORE, it is agreed as follows:

1. The Adviser shall pay, on its own behalf and on behalf of the Affiliates, a percentage of the premium for the Policies as shall be mutually agreed upon among the Adviser and the Funds, subject to the approval by the Board of Trustees of the Funds, including a majority of the non-interested trustees. From time to time, adjustments may be made to the percentage of the premiums paid by the Adviser by mutual agreement among the Adviser and the Funds, subject to the approval of the Board of Trustees of the Funds, including a majority of the non-interested directors or trustees. Each Fund shall pay a portion of the premium of each Policy under which it is covered, as allocated in such equitable manner as mutually agreed upon by the Funds, subject to the approval of the Board of Trustees of the Funds, including a majority of the non-interested trustees, which amounts are set forth on Schedule B to this Agreement. From time to time, adjustments may be made by mutual agreement of the Funds to the portion of the balance of the premiums theretofore paid by a Fund, subject to the approval of the Board of

Trustees of the Funds, including a majority of the non-interested trustees, based on a subsequent change or changes in the net assets of one or more Funds or the addition or withdrawal of a Fund or Series pursuant to this Agreement.

2. If each of the insurers issuing a Policy (the "Insurers") is willing, with or without additional premium, to add, as an Insured under a Policy, any investment company not listed as a signatory to this Agreement for which the Adviser or an Affiliate thereof is investment adviser, administrator or underwriter, or to add, as an Insured under a Policy, any affiliate of the Adviser, the Funds and the Adviser agree (a) that such addition may be made provided that the non-interested directors or trustees of the Funds covered by the Policy shall approve such addition and (b) that such additional entity may become a party to this Agreement and be included within the terms "Fund" or "party," provided that in each case such entity shall have executed and delivered to the Fund and the Adviser its written agreement to become a party hereto and to be bound by the terms of this Agreement.

3. In the event that the claims of loss of two or more parties as Insureds under a Policy are so related that the Insurers are entitled to assert that the claims must be aggregated, or in the event that the aggregate recovery by two or more Insureds under the Policies is less than the aggregate loss incurred by the Insureds that gave rise to the claims, the following rules shall determine, as among the claimant parties, the priority of satisfaction of the claims under the Policy.

[Option A: Each claimant party shall share pro rata in the amount of all recoveries under the Policy based upon the ratio of the amount of the premium under the Policy paid by such party to the total amount of all premiums under the Policy paid by all parties seeking recovery under the Policy with respect to such claims.]

[Option B: Neither the Adviser nor any Affiliate, if a claimant, shall receive any portion of the proceeds with respect to a claim under the Policies until each Fund claimant with respect to the same claim shall have received the proceeds equal to the full amount of its claim. When the condition has been fulfilled, the Adviser and any Affiliate may participate in the proceeds on the same basis as a Fund claimant.

Subject to the preceding subparagraph, proceeds with respect to a claim under the Policies shall be applied to the unsatisfied claim (or portion thereof) of each covered party by calculating the proportion which the unsatisfied claim (or portion thereof) of each covered party bears to the total unsatisfied claims (or portions thereof) of all parties and applying said proportion to the remaining amount of insurance paid.]

[Option C: Notwithstanding the above, no party may access coverage under the Policies to the extent such access would erode the minimum reserved coverage of any other party, as set forth in Schedule C, without the approval of such other party (including, for a Fund, the approval of the Board of Trustees of the Fund, including a majority of the non-interested trustees). Upon the expiration of a Policy, if a party has not made a claim or provided notice of a potential claim to the Insurer(s) during the Policy period, then such party's minimum reserved coverage is deemed to be released to satisfy the claims of any other party.]

4. The Adviser shall provide, on a quarterly basis, a report to the Funds' respective Boards which shall include:

(i) a description of any potential claim or claim made during the preceding calendar quarter under any of the Policies; and

(ii) a description of the current status of any matter previously reported by the Adviser to the Funds' respective Boards pursuant to this Section 4.

Notwithstanding the foregoing, the Adviser shall provide immediate notice to the Funds' respective Boards of any notice of potential claim or claim made under the Policy if, in the Adviser's reasonable judgment, the probable ultimate cost of the claim, including costs of defense, exceeds $___ million.

5. This Agreement shall become effective as of the date first above written, and shall remain in full force and effect with respect to the Policies during the effective period of the Policies as specified therein. Any party may withdraw from this Agreement and the Policies upon sixty (60) days' written notice to each of the other parties. The withdrawing party shall be entitled to receive its proportionate share of any premium refund received from the Insurer.

6. The obligations of the Funds that are organized as Massachusetts business trusts, or any other investment company organized as a Massachusetts business trust that may be added pursuant to Section 2 under this Agreement, with respect to a Series of such Funds, are not binding upon any of the trustees or holders of shares of beneficial interest of any such trust individually, but bind only the assets and property of such Series.

This Agreement shall supersede all prior premium sharing and allocation agreements entered into among the Funds and the Adviser, acting on its own behalf and on behalf of its Affiliates. Notwithstanding the foregoing, claims made under a Policy during a period prior to the effective date of this Agreement (and any recoveries related to any such claims) shall be subject to the terms of the premium sharing and allocation agreement in effect during that period.

IN WITNESS WHEREOF the parties have caused this Agreement to be executed by their officers or directors, as appropriate, hereunto duly authorized, all as of the day and year first above written.

Adviser:

By:_____

Funds:

By:_____

SCHEDULE A

INVESTMENT COMPANIES, PORTFOLIO SERIES AND AFFILIATES

SCHEDULE B

PREMIUM AMOUNTS

SCHEDULE C

MINIMUM RESERVED COVERAGE