The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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DISTRICT COURT HOLDS THAT THERE IS NO IMPLIED PRIVATE RIGHT OF ACTION UNDER SECTION 36(A) OF THE INVESTMENT COMPANY ACT

[18549] February 16, 2005 TO: BOARD OF GOVERNORS No. 8-05 CHIEF COMPLIANCE OFFICER COMMITTEE No. 14-05 COMPLIANCE ADVISORY COMMITTEE No. 13-05 SEC RULES MEMBERS No. 28-05 SMALL FUNDS MEMBERS No. 15-05 RE: DISTRICT COURT HOLDS THAT THERE IS NO IMPLIED PRIVATE RIGHT OF ACTION UNDER SECTION 36(A) OF THE INVESTMENT COMPANY ACT On January 21, 2005, the U.S. District Court for the Eastern District of New York granted the defendant's motion to dismiss the complaint in a class action filed under Section 36(a) of the Investment Company Act of 1940 and state law alleging a breach of fiduciary duty. 1 In particular, the plaintiff-shareholders alleged the defendants breached their fiduciary duty in connection with proposed rights offerings to shareholders by two publicly-traded closed end funds. The court held that no private right of action exists under Section 36(a). The District Court considered four factors in determining whether a private right of action should be implied under Section 36(a).2 First, whether the statutory provision explicitly provides a private right of action. If not, a court must presume that Congress did not intend to create one. The court noted that Section 36(a) does not explicitly provide a private right of action. Second, whether the provision contains language creating rights for persons who are protected under the statute or instead focuses only on the persons regulated. The court pointed out that Section 36(a) is devoted primarily to describing the actions that are prohibited and mentions investors only to say that a court, in awarding relief after the SEC has established its allegations of breach of fiduciary duty, should give "due regard" to the protection of investors. Third, whether the statute provides an alternative method of enforcement. As the Supreme Court has held "[t]he express provision of one method of enforcing a substantive rule 1 Chamberlain and Potapchuk v. Aberdeen Asset Management Ltd. and Aberdeen Asset Managers (C.I.) Limited, 2005 WL 195520 (E.D.N.Y.). 2 These four factors were based in particular on the holdings in Olmstead v. Pruco Life Ins. Co. of New Jersey, 283 F.3d 429 (2d Cir. 2002) and Alexander v. Sandoval, 532 U.S. 275 (2001). 2 suggests that Congress intended to preclude others."3 The District Court noted that Section 36(a) explicitly grants the SEC authority to bring an action alleging violation of fiduciary duties. Fourth, whether Congress provided a private right of action for enforcement of any other section of the statute. According to the court, "Congress's explicit provision of a private right of action to enforce one section of a statute suggests that omission of an explicit private right to enforce other sections was intentional." The court pointed out that Section 36(b) of the Investment Company Act created a private right of action by a shareholder against an adviser for a breach of the

duty not to charge excessive fees. Thus, by implication, the court noted that if Congress wished to create a private right of action for violations of Section 36(a), it could have done so. The court concluded that “[t]hese factors give rise to a strong presumption that Congress did not intend to create a private right of action for enforcement of [Investment Company Act Section] 36(a).” The court dismissed the claims under Section 36(a) with prejudice and declined to proceed further with the sate law claims. Jane G. Heinrichs Assistant Counsel 3 Alexander v. Sandoval, 532 U.S. 275, 290 (2001).
