

**MEMO# 19121**

August 29, 2005

# **COURT RULINGS ON MOTIONS TO DISMISS IN MULTIDISTRICT LITIGATION RELATING TO LATE TRADING AND MARKET TIMING**

©2005 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [19121] August 29, 2005 TO: BOARD OF GOVERNORS No. 43-05 PRIMARY CONTACTS - MEMBER COMPLEX No. 34-05 SEC RULES MEMBERS No. 96-05 SMALL FUNDS MEMBERS No. 73-05 RE: COURT RULINGS ON MOTIONS TO DISMISS IN MULTIDISTRICT LITIGATION RELATING TO LATE TRADING AND MARKET TIMING A U.S. District Court judge has ruled on motions to dismiss that were filed by the investment adviser to a family of mutual funds ("Funds") and other defendants in class action and derivative lawsuits relating to late trading and market timing activity in the Funds.<sup>1</sup> The judge's opinions, which grant in part and deny in part the motions to dismiss, are attached and briefly summarized below. With respect to the class action lawsuit filed by Fund investors, the judge determined that: All claims against the Funds are dismissed because any recovery against them would impose liability on "entirely innocent parties" (present shareholders). The antifraud claims under Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder are permitted to go forward, except that claims against certain broker-dealer defendants are dismissed. <sup>1</sup> In re Mutual Funds Investment Litig. (In re Janus Subtrack), Civ. No. 04-MD-15863 (MDL-1586), Inv. Class Opinion (D. Md. Aug. 25, 2005); In re Mutual Funds Investment Litig. (In re Janus Subtrack), Civ. No. 04-MD-15863 (MDL- 1586), Fund Derivative Opinion (D. Md. Aug. 25, 2005). The lawsuits in question are part of the multidistrict litigation ("MDL") involving the investment advisers and other affiliates of numerous fund families, traders who allegedly engaged in late trading and market timing of the funds' shares, and broker-dealers who allegedly facilitated that trading. The MDL is divided into "subtracks," each of which relates to a particular fund family. Each fund family subtrack includes consolidated complaints filed (1) by a purported class of investors in the funds and (2) derivatively, on behalf of the funds. The two other judges overseeing the MDL also will be ruling on motions to dismiss with respect to lawsuits in the other MDL subtracks. They are expected to issue opinions that adopt, modify or reject the rulings described above on issues common to the various subtracks. <sup>2</sup> The claims under Sections 11 and 12(a)(2) of the Securities Act are dismissed because plaintiffs did not - and cannot - allege facts demonstrating that they suffered the type of harm for which recovery is permitted under those provisions. The claim under Section 36(b) of the Investment Company Act (and the related claims under Section 48(a)) are permitted to go forward. In this respect, the opinion states that plaintiffs may assert a claim for recovery of

excessive fees and expenses resulting from the alleged scheme by the Funds' adviser and others, but may not use Section 36(b) as a means generally to challenge late trading and market timing practices or to recover profits paid to traders in connection with late trading or market timing transactions. The claims under Sections 34(b) and 36(a) of the Investment Company Act are dismissed because no private right of action exists under either provision. The various claims under state law are dismissed because they are preempted by federal law. The court granted leave to replead these claims, but only to the extent plaintiffs could "responsibly" do so. With respect to the class action lawsuit filed on behalf of the Funds, the judge determined that: The entire complaint (with the exception of a claim under Section 36(b) of the Investment Company Act and related claims under Section 48(a))<sup>2</sup> is dismissed because plaintiffs did not allege sufficient facts to excuse their failure to make demand upon the Funds' trustees before instituting the derivative action. The plaintiffs failed to state a claim under Section 47(b) of the Investment Company Act. There is no private right of action for damages under the Investment Advisers Act. Any potential recovery under the rescission provision in Section 215 of the Investment Advisers Act would be redundant of the claim for excessive fees under Section 36(b) of the Investment Company Act. We will keep you apprised of further developments with this litigation.

Elizabeth Krentzman General Counsel Attachment (in .pdf format) Note: Not all recipients receive the attachments. To obtain copies of the attachments, please visit our members website (<http://members.ici.org>) and search for memo 19121, or call the ICI Library at (202) 326-8304 and request the attachments for memo 19121. <sup>2</sup> There is a dispute between the derivative plaintiffs and the investor class plaintiffs as to which group is entitled to assert the Section 36(b) claim. The court noted that this issue will be resolved at a later stage of the litigation, but in the meantime, assigned the investor class plaintiffs the responsibility for pursuing the claim.