

MEMO# 18908

June 2, 2005

FEDERAL DISTRICT COURT GRANTS MOTION TO DISMISS SUIT AGAINST FUND SERVICE PROVIDER AND OFFICERS

©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. [18908] June 2, 2005 TO: BOARD OF GOVERNORS No. 26-05 CHIEF COMPLIANCE OFFICER COMMITTEE No. 44-05 COMPLIANCE ADVISORY COMMITTEE No. 41-05 SEC RULES MEMBERS No. 74-05 SMALL FUNDS MEMBERS No. 53-05 TRANSFER AGENT ADVISORY COMMITTEE No. 27-05 RE: FEDERAL DISTRICT COURT GRANTS MOTION TO DISMISS SUIT AGAINST FUND SERVICE PROVIDER AND OFFICERS The U.S. District Court for the Southern District of New York has dismissed a suit brought by a mutual fund ("Fund") shareholder claiming that the Fund's service provider "grossly inflated" the administrative and transfer agent fees it collected in violation of Section 36(b) of the Investment Company Act of 1940.* The court also dismissed the plaintiff's claims against two officers of the service provider and the Fund. According to the court's opinion, the service provider performs a number of administrative and other services on behalf of the Fund, including the preparation of tax returns, reports to shareholders, regulatory filings, and board materials. Between April 1, 2002 and March 31, 2003, the service provider charged administration fees of more than \$350,000. In addition, despite the fact that the Fund was closed to new investors, which the plaintiff argued should have reduced the need for administrative services, for the year ending March 31, 2004, the service provider received \$811,738 in administration fees from the Fund. The service provider also receives transfer agent fees for services related to issuing share certificates, executing purchase orders, maintaining shareholder records, mailing proxies, and other administrative functions. For the year ending March 31, 2003, the Fund paid the service provider \$96,500 in transfer agent fees. The next year, the service provider received \$162,197 in transfer agent fees, even though the Fund was closed to new investors for 10 out of those 12 months. The plaintiff alleged that the service provider received excessive administrative and transfer agent fees and that there is no rational justification for the dramatic increase in such fees over time. * See *Pfeiffer v. Integrated Fund Services, Inc.*, Scott A. Englehart, and Tina H. Bloom, 04 Civ. 7915 (DLC) (S.D.N.Y. May 18, 2005). A copy of the opinion and order is attached. 2 The plaintiff also alleged that by allowing the Fund to pay "grossly inflated" fees to the service provider, the two officers violated their fiduciary duty under Section 36(b) to the Fund and its shareholders to ensure that the fees and expenses paid by the Fund to the service provider bear a reasonable relationship to the actual services provided to the Fund. The defendants sought to dismiss the action on the basis that they did not receive compensation for advisory services and were not affiliated persons of the adviser and therefore not liable under Section 36(b). In

response, the court explained that, despite the defendants' contentions to the contrary, there is no requirement, either within the statutory language or the controlling case law, that a party must render investment advisory services to be liable under Section 36(b). According to the court, a review of the legislative history of Section 36(b), clarifies that Congress intended that three separate classes of persons can be sued under Section 36(b) – the investment adviser, affiliated persons of the investment adviser, and other persons enumerated in Section 36(a) who may have a fiduciary duty with respect to compensation or payments received by them for the fund. Although the court acknowledged that the service provider is a recipient of such compensation or payments, the court dismissed the action against it because the plaintiff failed to allege that the service provider "is a person enumerated under Section 36(a), thus depriving [the service provider] of fair notice of the grounds upon which the claim against it rests." The court also found that the plaintiff's claims against the two officers failed under Section 36(b)(3) because that provision expressly precludes an action against any person other than the recipient of compensation or payments and the plaintiff did not allege that the officers had received administrative and/or transfer agent fees. The court concluded by granting the defendants' motion for judgment on the pleadings. Jane G. Heinrichs Assistant Counsel Attachment (in .pdf format)

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