

**MEMO# 5959**

June 13, 1994

## **COURT FINDS PRIVATE RIGHTS OF ACTION UNDER SECTION 17(J) AND SECTION 36(A)**

June 13, 1994 TO: CLOSED-END FUND COMMITTEE NO. 15-94 SEC RULES COMMITTEE NO. 61-94 RE: COURT FINDS PRIVATE RIGHTS OF ACTION UNDER SECTION 17(j) AND SECTION 36(a) \_\_\_\_\_ The United States District Court for the District of Delaware recently held that an implied private right of action exists under Section 17(j) and Section 36(a) of the Investment Company Act and Rule 17j-1 thereunder. A copy of the court's opinion is attached. Limited partners of two business development companies brought an action against the general partner and the investment adviser to the BDC's. In 1990, the BDC's bought notes issued by a financially ailing company in which several of the defendants had existing interests. In 1991, the BDC's sold a stock option to a company partially controlled by the adviser. Plaintiffs alleged that these transactions violated Section 17(j) and Rule 17j-1. The court held that plaintiffs "are within the class of persons to be protected by section 17(j)" and that the plaintiffs' complaint "states a cognizable cause of action" under Section 17(j) and Rule 17j-1. Defendants also asserted that Section 17(j) and Rule 17j-1 apply "only to those situations where an 'insider' purchases or sells securities that (a) are already owned by an investment company or (b) are being considered for acquisition by the investment company." Plaintiffs argued that Rule 17j-1 should be read to prohibit an access person "through his/her position of influence, to cause an investment company to purchase or sell securities already owned by that access person, particularly in situations where the access person expects to personally benefit by the investment company's purchase or sale." The court found that plaintiffs' interpretation was "at least plausible" and denied defendant's motion to dismiss for failure to state a claim. Plaintiffs also alleged violations of Section 36(a) in connection with certain transactions. The court held that "Congress intended courts to . . . imply private rights of action for conduct proscribed under section 36(a)" and that plaintiffs "have stated a cognizable cause of action" under that section. The court found that no private action for aiding and abetting exists under the Investment Company Act. Finally, the court held that the statute of limitations applicable to the Investment Company Act is one year from the date of discovery and three years from the date of the violation. Thomas M. Selman  
Assistant Counsel Attachment