

**MEMO# 12658**

September 21, 2000

## **SEC SUBMITS SUPPLEMENTAL AMICUS BRIEF ON IMPLIED PRIVATE RIGHT OF ACTION UNDER SECTION 36(A) OF THE INVESTMENT COMPANY ACT**

[12658] September 21, 2000 TO: BOARD OF GOVERNORS No. 55-00 CLOSED-END INVESTMENT COMPANY COMMITTEE No. 25-00 DIRECTOR SERVICES COMMITTEE No. 13-00 SEC RULES COMMITTEE No. 115-00 RE: SEC SUBMITS SUPPLEMENTAL AMICUS BRIEF ON IMPLIED PRIVATE RIGHT OF ACTION UNDER SECTION 36(a) OF THE INVESTMENT COMPANY ACT The Securities and Exchange Commission recently submitted a supplemental brief as amicus curiae in class actions brought by a shareholder in three closed-end investment companies,<sup>1</sup> in which it continues to argue that there is an implied private right of action under Section 36(a) of the Investment Company Act of 1940. The SEC's brief responds to an amicus curiae brief filed by the Investment Company Institute in the class actions, in which the ICI asserts that there is no implied private right of action under Section 36(a) of the Investment Company Act.<sup>2</sup> In its supplemental brief, the SEC contends that Section 1(b) of the Investment Company Act contains a unique "congressional directive," which provides that the Investment Company Act's provisions shall be interpreted "to mitigate and eliminate the condition where managers of investment companies put their interests ahead of those of shareholders – the very abuse addressed by Section 36(a)." Accordingly, since a private right of action is necessary and appropriate to protect shareholders from the management misconduct covered by Section 36(a), courts should interpret the Investment Company Act as giving rise to a private right of action for breach of fiduciary duty under Section 36(a). The SEC's brief further asserts that "in accordance with the directive of Section 1(b)," numerous decisions of the Second Circuit and other courts of appeals over the years have recognized implied rights of action under the Investment Company Act. 1 *Marquit v. Williams, et. al.*, Case No. 00-7085(L) (2d Cir. May 2000). The original actions asserted breach of fiduciary duty claims under Section 36(a) against the funds' directors and investment advisers. The district court dismissed the actions, finding that the claims were derivative in nature and, as a result, the shareholder was required to make a demand on the funds' directors prior to bringing a suit or to show that such a demand would be futile. The plaintiff has appealed that decision to the U.S. Court of Appeals for the Second Circuit. 2 See Memorandum to Board of Governors No. 51-00; Closed-End Investment Company Committee No. 23-00; Director Services Committee No. 12-00; and SEC Rules Committee No. 109-00, dated August 23, 2000 (transmitting the Institute's amicus brief). 2The SEC also argues in its brief that the legislative histories of the 1970 and 1980 amendments to the Investment Company Act demonstrate congressional intent to preserve a private right of action under Section 36(a). The SEC's brief maintains that when Congress

amended the Investment Company Act in 1970 to create the present version of Section 36(a), it did so in the “legal context” of the Section 1(b) directive and widespread recognition of private rights of action under the Investment Company Act, therefore indicating “its intent to preserve a private right of action under Section 36.” Additionally, the brief claims that when Congress amended the Investment Company Act in 1980 “to loosen certain regulatory restrictions, it did so based on its understanding that there was a private right of action under Section 36(a).” Finally, the SEC’s brief contends that “contrary to the ICI’s position,” Section 36(a) does contain a prohibition on certain types of misconduct. The brief argues that Section 36(a) does not merely authorize Commission actions against violations that are otherwise prohibited under the Investment Company Act, it expressly authorizes Commission actions against specific acts or practices, “namely, those constituting a breach of fiduciary duty involving personal misconduct on the part of an officer, director or adviser of an investment company.” The SEC’s brief concludes that, by authorizing Commission actions against certain acts and practices, Section 36(a) “necessarily prohibits those acts and practices.” Doretha VanSlyke Zornada Assistant Counsel Attachment Attachment (in .pdf format)

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