

MEMO# 14555

March 19, 2002

SECOND CIRCUIT CONFIRMS NO PRIVATE RIGHT OF ACTION UNDER SECTIONS 26 AND 27 OF THE INVESTMENT COMPANY ACT

[14555] March 19, 2002 TO: BOARD OF GOVERNORS No. 12-02 SEC RULES MEMBERS No. 20-02 VARIABLE INSURANCE PRODUCTS ADVISORY COMMITTEE No. 1-02 RE: SECOND CIRCUIT CONFIRMS NO PRIVATE RIGHT OF ACTION UNDER SECTIONS 26 AND 27 OF THE INVESTMENT COMPANY ACT The U.S. Court of Appeals for the Second Circuit has confirmed the dismissal of a class action lawsuit against an insurer that issued variable annuity insurance contracts and its parent.* The complaint alleged that the management fees, expenses and charges associated with the contracts were excessive and unreasonable in relation to the services provided, the charges incurred and the risk assumed in violation of the Investment Company Act of 1940 (the "Act"). The District Court dismissed the complaint on the grounds that the Act does not provide a private right of action for violations of Sections 26(f) and 27(i), the provisions of the Act that make it unlawful to impose unreasonable charges and fees in connection with an account funding variable insurance contracts. On appeal the Second Circuit upheld the dismissal. Conducting a de novo review of the District Court's dismissal of the complaint, the Second Circuit first looked to congressional intent to determine whether, in fact, a private right of action exists for violations of the Act. The court found that "without congressional intent, a cause of action does not exist and courts may not create one, no matter how desirable that might be as a policy matter, or how compatible with the statute" (citations omitted). It also found that a court cannot ordinarily conclude that Congress intended to create a right of action when none was explicitly provided. In this case, no provision of the Act explicitly provides for a private right of action for violations of either Section 26(f) or 27(i), so the court determined that it must presume none was intended. The court found that this presumption is strengthened by the following factors: 1) the sections do not contain rights-creating language; 2) Section 42 of the Act explicitly provides for enforcement of all provisions of the Act by the Securities and Exchange Commission through investigations and civil suits for injunctions and penalties; and 3) Congress's explicit provision of a private right of action under Section 36(b) of the Act suggests that omission of an explicit private right to enforce other sections was intentional. * *Olmsted v. Pruco Life Insurance Co.*, No. 00-9511 (2nd Cir., March 7, 2002). 2 Plaintiffs attempted to rebut the strong presumption against creating a private right of action in this case by arguing that implied rights of action had been recognized in the past as a way of promoting the policies served by the Act, that courts had recognized other implied rights at the time Sections 26(f) and 27(i) were added to the Act, and that the legislative history relating to both the 1980 and 1996 amendments to the Act

suggests that Congress intended to recognize implied rights of action. The court rejected these arguments and concluded that “where the text of a statute is unambiguous, the judicial inquiry is complete[] except in rare and exceptional circumstances” and legislative history is instructive only upon “the most extraordinary showing of contrary intentions” (citations omitted). It found neither ambiguity nor evidence of contrary intentions existed in this case. Finally, the Second Circuit rejected the Plaintiffs’ argument that Congress must have intended private rights of action because it failed to appropriate sufficient funds to the Securities and Exchange Commission to do the job itself. The court declined to link statutory intent to budget allocations. A copy of the opinion is attached. Marguerite C. Bateman Associate Counsel Attachment Note: Not all recipients receive the attachment. To obtain a copy of the attachment, please visit our members website (<http://members.ici.org>) and search for memo 14555, or call the ICI Library at (202) 326-8304 and request the attachment for memo 14555. Attachment (in .pdf format)

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