

MEMO# 2326

November 20, 1990

COURT FINDS NO PRIVATE RIGHT OF ACTION UNDER SECTION 37 OF THE 1940 ACT

November 20, 1990 TO: SEC RULES MEMBERS NO. 77-90 RE: COURT FINDS NO PRIVATE RIGHT OF ACTION UNDER SECTION 37 OF THE 1940 ACT

In a recent derivative action brought in federal district court by a fund shareholder alleging excessive management fees, the court found, among other things, that controlling law in the relevant circuit (Eighth) established that the 1940 Act does not create a private right of action to recover damages for violations of Section 37 of the Act. A copy of the court's opinion is attached. In addition to asserting a claim under Section 36(b), the complaint alleged that the defendants (the fund's manager, transfer agent and certain officers and directors) unlawfully converted fund assets to their own use or the use of others, in violation of Section 37 of the 1940 Act. Section 37 subjects anyone who steals or embezzles from an investment company to the penalties prescribed by Section 49 of the 1940 Act (in the absence of a state court judgment on the merits with respect to the same act or acts). In dismissing the Section 37 count, the court noted that in view of the earlier controlling decision, it was not necessary to determine whether a private right of action under Section 37 for excessive fees, previously recognized by the Second Circuit, was preempted by the adoption of Section 36(b) of the 1940 Act in 1970. The court acknowledged that a subsequent Eighth Circuit decision criticized the previous case in light of various Supreme Court decisions favoring recognition of private rights of action under the federal securities laws. The court further observed, however, that the more recent trend has been to limit the availability of such rights of action. Frances M. Stadler Assistant General Counsel Attachment