MEMO# 12520

August 23, 2000

ICI SUBMITS AMICUS BRIEF ON IMPLIED PRIVATE RIGHT OF ACTION UNDER SECTION 36(A) OF THE INVESTMENT COMPANY ACT

[12520] August 23, 2000 TO: BOARD OF GOVERNORS No. 51-00 CLOSED-END INVESTMENT COMPANY COMMITTEE No. 23-00 DIRECTOR SERVICES COMMITTEE No. 12-00 SEC RULES COMMITTEE No. 109-00 RE: ICI SUBMITS AMICUS BRIEF ON IMPLIED PRIVATE RIGHT OF ACTION UNDER SECTION 36(a) OF THE INVESTMENT COMPANY ACT The Investment Company Institute recently submitted a brief as amicus curiae in class actions brought by a shareholder in three closed-end investment companies,1 in which it asserts that there is no implied private right of action under Section 36(a) of the Investment Company Act of 1940. The Institute's brief responds to an amicus curiae brief filed by the U.S. Securities and Exchange Commission in the class actions, in which the SEC asks the court to hold "that investment companies as well as shareholders have an implied right of action under Section 36(a) of the Investment Company Act." In its brief, the Institute states that on its face, Section 36(a) empowers the SEC to bring an action in federal court for injunctive and other relief against an officer, director, investment adviser, or principal underwriter of a registered investment company if any such person has engaged "in any act or practice constituting a breach of fiduciary duty involving personal misconduct." Section 36(a) does not, however, prohibit any conduct or make any conduct unlawful. Accordingly, because Section 36(a) prohibits nothing, it cannot afford a right of action. The Institute's brief explains that the SEC has construed the statute in this manner in a formal adjudicative opinion where it held that Section 36(a) cannot be the basis for an SEC administrative proceeding because it creates no duties or liabilities, i.e., it cannot be violated. Moreover, the Supreme Court has recently held that while federal courts in limited circumstances may infer a remedy for a statutory wrong, they lack the authority to "extend liability beyond the scope of conduct prohibited by the statutory text." The Institute's brief further contends that even assuming arquendo that Section 36(a) does proscribe certain conduct, the provision nevertheless cannot support a private right of action. In recent years the Supreme Court has taken a more restrictive approach to inferring private remedies for violations of statutes not expressly authorizing them, and courts today will not infer private rights of action absent strong evidence of Congressional intent to create or preserve such remedies. The Institute argues that, against this backdrop, Section 36(a) presents an unusually weak case for inferring a private action. The 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. 2most important indication of legislative intent – the language of the statute – essentially forecloses an argument that Congress intended to provide a private action in Section 36(a). Enacted by Congress in 1970, subsection (a) provides for an action only by the Commission, while subsection (b) explicitly authorizes actions by both the SEC and by private investors. The brief concludes that "one would have to assume that Congress absentmindedly forgot to add private persons to subsection (a) in order to infer a private right of action under it." In addition, the Institute's brief contends that the argument in the SEC's amicus brief –that the strong statutory role given to independent directors of investment companies requires that those companies be given an implied right of action – finds no support in either the statute or in legislative history. The Institute's brief states that the SEC's argument is largely a policy discussion on the importance of independent fund directors. The Institute agrees with the SEC regarding the importance of independent directors. The brief asserts, however, that "while Congressional recognition of the role of independent directors would support permitting the funds themselves to pursue any private remedies that Congress intended, it cannot shed light on whether Congress intended a private remedy in the first place." Doretha VanSlyke Zornada Assistant Counsel Attachment

---