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A legal update from Dechert's Financial Services and Financial Services and Securities Litigation Groups

New York Federal Court First To Hold That There Is No Implied Private Right of Action Under Section 36(A) Of The Investment Company Act of 1940

On January 21, 2005, the U.S. District Court for the Eastern District of New York granted defendants' motion to dismiss the complaint in an action entitled *Chamberlain and Potapchuk v. Aberdeen Asset Management Ltd. and Aberdeen Asset Managers (C.I.) Limited*, 2005 WL 195520. The plaintiffs in this purported class action alleged breaches of fiduciary duty under Section 36(a) of the Investment Company Act of 1940 ("ICA") and state law by defendants arising out of proposed rights offerings to shareholders by two publicly traded closed end funds. The court held that no private right of action exists under Section 36(a). Dechert LLP represented the defendants in this case.

Plaintiffs have invoked Section 36(a) for many years, and increasingly over the last two years, as a means of creating a federal fiduciary duty standard in certain circumstances. To our knowledge, this decision was the first in which a federal court held that there was no private right of action under Section 36(a), although such a cause of action previously had been repeatedly upheld. The District Court rejected that line of authority as part of an outdated '*ancien regime*.' This analysis may also affect future decisions considering implied rights of action under Sections 34(b) and 48(a) of the ICA in the various pending mutual fund class actions.

In reaching this result, the District Court relied heavily on the decision of the Court of Appeals for the Second Circuit in *Olmsted v. Pruco Life Ins. Co. of New Jersey*,[1] which held that no private right of action should be implied under a different section of the ICA. In reaching that result, that Court of Appeals noted that the U.S. Supreme Court had, particularly in *Alexander v. Sandoval*, moved sharply towards a more restrictive view of under what circumstances it was appropriate to infer a private cause of action where no express provision to that effect existed in a federal statute.[2]

The District Court, relying specifically on *Olmsted* and *Sandoval*, considered four factors in its analysis of whether a private right of action should be implied under Section 36(a):

First, the District Court looked at whether the provision explicitly provides a private right of action. If the answer is no, a court must presume that Congress did not intend to create one. Section 36(a) of the ICA explicitly provides only that the SEC is empowered to enforce the provision. The court found the omission of any reference to private claims in that context to be important.

Second, the District Court looked to whether Section 36(a) contains language creating rights for persons who are protected under the statute or instead only

1 283 F.3d 429 (2d Cir. 2002).

2 532 U.S. 275, 290 (2001).

focuses on the persons regulated by the statute. Section 36(a) of the ICA primarily describes the conduct that is prohibited and mentions investors only to say that, in awarding relief after the Securities and Exchange Commission has alleged and proven a breach of fiduciary duty, a court should give "due regard" to the protection of investors.

Third, the District Court considered whether the statute provides an alternative method of enforcement. As the U.S. Supreme Court has held, "[t]he express provision of one method of *enforcing* a substantive rule suggests that Congress intended to preclude others."[3] As noted above, the explicit grant of authority to enforce Section 36(a) to the SEC mitigated any implication of a private claim for that reason as well.

Finally, the District Court considered whether Congress provided a private right of action for enforcement of any other section of the statute. Congress's explicit provision of a private right of action to enforce one section of a statute suggests that omission of an explicit private right to enforce other sections was intentional. The court pointed out that Section 36(b) of the ICA creates a private right of action by a shareholder against the adviser for a breach of the duty not to charge excessive fees. This provision suggests that if Congress wished to create a private right of action for violations of Section 36(a), it could have done so, as it did for Section 36(b).

The court concluded that "[t]hese factors give rise to a strong presumption that Congress did not intend to create a private right of action for enforcement of ICA § 36(a)." In reaching that result, the District Court found that numerous prior decisions were premised on faulty, outdated reasoning and that the asserted indications of Congressional intent to create an implied cause of action under this provision were not persuasive. The court dismissed the claims under Section 36(a) with prejudice and declined to proceed further with the state law claims for which the plaintiffs alleged supplemental (pendent) jurisdiction.

[3] *Alexander v. Sandoval*, 532 U.S. 275, 290 (2001).

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