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THE DEMAND REQUIREMENT OF RULE 23.1 IN ACTIONS BROUGHT
UNDER SECTION 36(B) OF THE INVESTMENT COMPANY ACT
OF 1940

I. INTRODUCTION

Section 36(b) of the Investment Company Act of 1940¹ ("ICA") imposes on the investment adviser of a registered investment company "a fiduciary duty with respect to the receipt of compensation for services."² An action alleging a breach of this duty may be brought "by the [Securities and Exchange] Commission, or by a security holder of a registered investment company on behalf of such company" to recover excessive fees paid to the investment adviser.³ The section does not provide an express right of action in the investment company, itself. At first glance, it would appear that a shareholder of a registered investment company has an unfettered right of action under section 36(b) against the investment adviser. However, three circuit courts of appeals have found it necessary to determine whether the demand requirement of Rule 23.1 of the Federal Rules of Civil Procedure must be satisfied before such a plaintiff-shareholder may maintain a section 36(b) action.⁴ Rule 23.1 requires that prior to bringing a derivative action to enforce the right of a corporation, a shareholder of the corporation must formally demand that the corporation's board of directors pursue the claim.⁵

1. 15 U.S.C. § 80a-35(b)(1982).

2. *Id.* Section 36(b) provides in pertinent part as follows:

[T]he investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company, or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser.

Id.

3. *Id.* Section 36(b) provides in pertinent part as follows:

An action may be brought under this subsection by the Commission, or by a security holder of such registered investment company on behalf of such company against such investment adviser, or any affiliated person of such investment adviser, or any other person enumerated in subsection (a) of this section who has a fiduciary duty concerning such compensation or payments, for breach of fiduciary duty in respect of such compensation or payments paid by such registered investment company or by the security holders thereof to such investment adviser or person.

Id.

4. See *Grossman v. Johnson*, 674 F.2d 115 (1st Cir.), *cert. denied*, 103 S. Ct. 85 (1982); *Weiss v. Temporary Investment Fund, Inc.*, 692 F.2d 928 (3d Cir. 1982); *Fox v. Reich & Tang, Inc.*, 692 F.2d 250 (2d Cir. 1982), *cert. granted*, 103 S. Ct. 1271 (1983).

5. FED. R. CIV. P. 23.1. Rule 23.1 states in pertinent part as follows:

In a derivative action brought by one or more shareholders or members to enforce a right of a corporation . . . , the corporation . . . , having failed to enforce a right which may properly be asserted by it, . . . the complaint

In two of the cases to reach the court of appeals, the First and Third Circuits held that because the investment company has an implied right of action under section 36(b), demand must be made as a prerequisite to a plaintiff-shareholder bringing suit.⁶ However, in the third case, *Fox v. Reich & Tang, Inc.*,⁷ a decision in which the Supreme Court has granted certiorari,⁸ the Second Circuit could find no implied cause of action by the company against its investment adviser under section 36(b).⁹ Consequently, the court held that the requirements of Rule 23.1 need not be satisfied, and that a plaintiff-shareholder need not make a demand on the company's directors prior to instituting suit.¹⁰

In order to understand the import of the issues raised in *Fox*, it is not only necessary to examine the history of the investment company industry but also to analyze the unique relationship that exists between a mutual fund, one type of investment company, and its investment adviser. This note will begin with a discussion of the conflict of interest engendered by the relationship between an investment company and its investment adviser. It will then examine the legislative efforts to remedy this conflict that lead to the Congressional amendment of the ICA to include section 36(b). It will then focus on the interaction between section 36(b) and the demand requirement of Rule 23.1 of the Federal Rules of Civil Procedure. The issues raised by the interaction of section 36(b) and Rule 23.1 are (1) does the investment company have an implied cause of action under section 36(b) necessary to

shall . . . allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors . . . and the reasons for his failure to obtain the action or for not making the effort.

Id. For a general discussion of the demand requirement, see generally, Comment, *The Demand and Standing Requirements in Stockholder Derivative Actions*, 44 U. CHI. L. REV. 168 (1976).

Judicial interpretation of the demand requirement of Rule 23.1 has been inconsistent in the various federal circuits. See 3B J. MOORE, MOORE'S FEDERAL PRACTICE ¶ 23.119 (2d ed. 1982). Professor Moore in discussing the inconsistencies expressed that "there is no unanimity of opinion among the courts, and probably the most straightforward approach is to admit frankly that it lies within the sound discretion of the court to determine the necessity for a demand." *Id.* Generally, the Supreme Court has chosen not to hear controversies involving conflicts in the application of the demand requirement of Rule 23.1, instead allowing each circuit to develop its own standards. Comment, *supra*, at 171. There are, however, Supreme Court cases predating the enactment of Rule 23.1 which discuss the demand on directors requirement. See *Wathen v. Jackson Oil and Ref. Co.*, 235 U.S. 635 (1915); *Delaware & H. Co. v. Albany & S.R.R.*, 213 U.S. 435 (1909); *Doctor v. Harrington*, 196 U.S. 579 (1905); *Corbus v. Alaska Treadwell Gold Mining Co.*, 187 U.S. 455 (1903); *Taylor v. Holmes*, 127 U.S. 489 (1888); *Quincy v. Steel*, 120 U.S. 241 (1887); *Dimpfell v. Ohio & M. Ry.*, 110 U.S. 209 (1884); *Hawes v. Oakland*, 104 U.S. 450 (1882).

6. *Grossman v. Johnson*, 674 F.2d 115 (1st Cir.), *cert. denied*, 103 S. Ct. 85 (1982); *Weiss v. Temporary Investment Fund, Inc.*, 692 F.2d 928 (3d Cir. 1982).

7. 692 F.2d 250 (2d Cir. 1982), *cert. granted*, 103 S. Ct. 1271 (1983).

8. 103 S. Ct. 1271 (1983).

9. 692 F.2d at 253.

10. *Id.* at 262.

trigger the requirements of Rule 23.1; (2) assuming an implied cause of action does exist, is demand required in a section 36(b) action; and (3) should demand always be presumed futile in a section 36(b) action due to the nature of the relationship between investment company directors and the investment adviser. Finally, following a discussion of these issues, an argument will be made that no demand is necessary in an action under section 36(b) because no implied cause of action exists, and, therefore, Rule 23.1 should not be invoked.

II. THE ORIGIN OF THE PROBLEM: THE MUTUAL FUND, THE ICA AND RULE 23.1

Investment companies¹¹ first appeared in the early 1920's and quickly gained popularity as a result of their ability to allow an investor to diversify his portfolio at a low cost.¹² During the late nineteen-twenties and early nineteen-thirties, investment companies sustained substantial economic losses.¹³ Although this financial decline was due in large measure to the stock market crash of 1929,¹⁴ considerable economic difficulties resulted

11. Investment companies are organizations that sell their shares to the public and then use the proceeds to invest in corporate and governmental securities. Note, *Mutual Fund Independent Directors: Putting a Leash on the Watchdogs*, 47 *FORDHAM L. REV.* 568 (1979). This note will focus on mutual funds, a type of investment company which at least one commentator has claimed are economically the most significant segment of the investment company industry. See Comment, *Termination of Management Contracts Under the Investment Company Act of 1940*, 63 *COLUM. L. REV.* 733 (1963). A mutual fund is an "open-end" type of investment company whose shares are continuously offered to the public and which are redeemable at any time by the shareholder for their net asset value. Modesitt, *The Mutual Fund—A Corporate Anomaly*, 14 *U.C.L.A. L. REV.* 1252 (1967).

Another type of investment company is the "close-end" company which sells its shares in normal market transactions. *Id.* at n.2. These shares are neither redeemable nor offered on a continuing basis. *Id.*

12. Note, *Director Dismissal of Shareholder Derivative Suits Under the Investment Company Act*: *Burks v. Lasker*, 11 *LOY. U. CHI. L.J.* 519, 523-24 (1980). The normal investor has neither the time it takes to become an expert in all of the stocks and the securities which are offered to the public, nor the financial resources necessary to invest in enough different stocks to sufficiently diversify his portfolio to minimize market risks. The investment company, which combines the assets of a number of investors to invest in a diversified portfolio under the supervision of a professional investment adviser, provides such opportunities for the average investor. Tolins, *The Investment Company Act of 1940*, 26 *CORNELL L. REV.* 77, 83 (1940). The initial success of the investment company is shown by the fact that by 1929 there were 600 investment companies totalling over eight billion dollars in assets. Note, *supra*, at 524. For a general discussion of the development of investment companies, see BULLOCK, *THE STORY OF INVESTMENT COMPANIES* (1959).

13. SEC Report on Investment Trusts and Investment Companies, Pursuant to § 30 of the Public Utility Holding Co. Act of 1935. Part III, ch. 1, 2 (1940). Total investment company assets dropped to a low of two billion dollars in 1932. *Id.* at 17. During this period many investment companies were forced into bankruptcy, receivership or dissolution. Tolins, *supra* note 12, at 82.

14. For a general discussion of the stock market crash of 1929 see G. AXON, *THE STOCK MARKET CRASH OF 1929* (1974); J. GALBRAITH, *THE GREAT CRASH OF 1929* (1972).

from fund mismanagement and organizer self-dealing.¹⁵ In an attempt to regulate both investment companies as well as the securities industry as a whole, thereby protecting the investment public from these and similar abuses,¹⁶ Congress enacted the Securities Act of 1933 and the Securities Exchange Act of 1934.¹⁷ However, these initial attempts to regulate investment companies proved to be inadequate; even after their passage, "manipulative schemes, pyramiding, exorbitant advisory and underwriting fees, insider dealings and looting" persisted as problems with the investment company form.¹⁸ In 1940, Congress passed the Investment Company Act to deal with these continuing abuses.¹⁹ While the ICA was generally successful in preventing abuses of the investment company form, one serious problem remained: the inherent conflict of interest existing between the mutual fund

15. Note, *supra* note 12, at 524.

16. These abuses included: 1) investments by investment companies in illiquid ventures which benefited only those individuals in control of the investment company; 2) pyramiding, a practice of investing in the securities issued by other investment companies and creating duplicated management fees; 3) purchases by the investment company of unwanted securities held by persons in control of the fund at unreasonably high prices; 4) looting of company assets by insiders; 5) "switching", a practice which involves setting up a second investment company and inducing shareholders of the first to switch their investment to the second solely to generate sales commissions. See Comment, *The Mutual Fund Industry: A Legal Survey*, 44 NOTRE DAME LAW. 732, 787-92 (1969).

17. Comment, *Mutual Funds and Independent Directors*, 1972 DUKE L.J. 429, 433-34. For the text of these Acts, see 15 U.S.C. §§ 77a-77aa, 78a-78hh-1 (1982). Mutual funds are covered by the Securities Act of 1933 and the Securities Exchange Act of 1934 because they issue their own securities and distribute them directly through their own salesmen or others. Randall, *Fiduciary Duties of Investment Company Directors and Management Companies Under the Investment Company Act of 1940*, 31 OKLA. L. REV. 635 (1978). The 1933 and 1934 acts impose disclosure and anti-fraud provisions on corporations issuing securities and on those entities through which the securities are traded. Comment, *supra*, at 434.

18. Comment, *supra* note 11, at 736. The Securities Acts, which focus on requiring complete and truthful disclosure of all material facts to the investing public, proved to be inadequate when dealing with investment companies. *Id.* See also Randall, *supra*, note 17, at 637 n. 13.

19. Investment Company Act of 1940, Pub. No. 768, 54 Stat. 789 (codified as amended at 15 U.S.C. §§ 80a-1 *et seq.* (1982)). The ICA has been termed "the most complex of the Federal securities acts." Note, *supra* note 12, at 526. The ICA as enacted in 1940 contained the following requirements: 1) registration of all investment companies, Investment Company Act of 1940, § 17, Pub. No. 768, 54 Stat. 815-17 (codified as amended at 15 U.S.C. § 80a-18 (1982)); 2) disclosure of investment and financing policies, *id.* § 13, 54 Stat. 811 (codified as amended at 15 U.S.C. § 80-13 (1982)); 3) regulation of the custody of assets, *id.* § 30, 54 Stat. 836-37 (codified as amended at 15 U.S.C. § 80a-29 (1982)); 4) adequate reserves for redemption, and prohibiting transactions between the fund and its officers, directors and affiliates unless SEC approved, *id.* § 22, 54 Stat. 823-25 (codified as amended at 15 U.S.C. § 80a-22 (1982)); 5) that a percentage of the fund's directors be independent of the investment adviser; and 6) approval of the advisory contract by the shareholders, subject to periodic negotiations. *Id.* §§ 10, 16, 54 Stat. 806-08, 812-13 (codified as amended at 15 U.S.C. §§ 80a-10 & -15(a) (1982)). The act also made it a federal crime to convert, embezzle, or steal investment company assets. *Id.* § 37, 54 Stat. 841 (codified as amended at 15 U.S.C. § 80a-36 (1982)).

and its investment adviser.²⁰ This conflict of interest derived from both the structure of the mutual fund and the relationship of the investment adviser to the fund.

While, in theory, a mutual fund is created by a group of investors who pool their assets in order to reduce investment costs, in reality it is formed by an existing management composed of investment bankers, brokers or investment counselors who seek to promote wider use of their services.²¹ The structure of the mutual fund is unique because an investment adviser hired by the fund not only organizes the fund, but also, selects its first board of directors.²² The board of directors of the fund and the fund's investment adviser then enter into a written contract setting forth the compensation to be paid the adviser for managing the assets of the fund.²³ Because the fee is

20. Comment, *Duties of the Independent Director in Open-End Mutual Funds*, 70 MICH. L. REV. 696, 697 (1972). For a further discussion of this inherent conflict, see notes 22 & 23 and accompanying text, *infra*. The relationship between the adviser and the investment company has been described as "business incest" and a "corporate anomaly." Modesitt, *supra* note 18, at 1252; Note, *The Mutual Fund and Its Management Company: An Analysis of Business Incest*, 71 YALE L.J. 137 (1961).

21. Comment, *supra* note 11, at 735. As one commentator observed: "The fund is organized and promoted by persons who usually have an existing investment management organization, such as a brokerage house or an investment banking firm." Randall, *supra* note 17, at 636.

22. Freeman, *The Use of Mutual Fund Assets to Pay Marketing Costs*, 9 LOY. U. CHI. L.J. 533, 534 (1978); Note, *supra* note 11, at 570-71. It has been observed, that "[u]nlike a regular business corporation whose affairs are 'internally managed' by its officers and board of directors, the assets of most mutual funds are externally managed by an investment adviser." Freeman, *supra*, at 534. The investment adviser is usually a member of an investment management corporation, a corporation which specializes in providing professional investment advice. The investment management corporation, or investment adviser, externally manages the fund. It is for this reason that mutual funds have been characterized as mere corporate "shells." Note, *supra* note 11, at 571. The adviser may also serve as underwriter to the fund when its shares are offered to the public or as broker for the fund's portfolio transactions. *Id.*

23. Note, *supra* note 11, at 571. The ICA requires that the parties enter into a written contract fully describing any compensation which the adviser is to receive. Investment Company Act of 1940, § 15, 15 U.S.C. § 80a-15 (1982). Because the members of the fund's board of directors have been selected by, or have close ties with, the investment adviser, they are often faced with the conflicting interests of maximizing profits for the adviser and representing the best interests of the shareholders by negotiating the lowest fees possible. Mundheim, *Some Thoughts on the Duties and Responsibilities of Unaffiliated Directors of Mutual Funds*, 115 U. PA. L. REV. 1058, 1059-60 (1967). Because of this peculiar relationship it has been stated that in the mutual fund industry "self-dealing is not the exception but so far as management is concerned, the order of the day." *Moses v. Burgin*, 445 F.2d 369, 376 (1st Cir.), *rev'g*, 316 F. Supp. 31 (D. Mass 1970), *cert. denied*, 404 U.S. 994 (1971). Due to the fact that affiliated directors have picked the independent directors and that the latter must rely on the adviser for all statistical and accounting information necessary for analysis of the adviser contract, even the ICA's statutory requirement that a percentage of the board of directors be independent does not preclude abuse. Note, *Private Rights of Action Against Mutual Fund Investment Advisers: Amended Section 36 of the 1940 Act*, 120 U. PA. L. REV. 143, 145-46 (1971). See Investment Company Act of 1940, § 15(a), 15 U.S.C. § 80a-10(a) (1982) (requiring that no registered investment company have more than 60% of its directors interested).

set as a percentage of the fund's net assets, the amount of compensation paid to the adviser increases as the assets of the fund continue to grow.²⁴ This parallel asset-fee increase results even in the absence of an accompanying increase in the services performed by the adviser.²⁵

Between 1959 and 1966, more than eighty civil suits were filed by shareholders of mutual funds who alleged that the compensation paid to a particular investment adviser was legally excessive.²⁶ However, only three cases were tried on the merits, and in none of these actions was the position of the shareholder upheld.²⁷ Responding to plaintiffs' failures in advisory-fee litigation, in 1966, the SEC undertook a study of the ICA and its potential impact on mutual fund growth.²⁸ The SEC report concluded that the existing external management structure of the mutual fund industry effectively precluded shareholders from benefiting from decreased management costs.²⁹

24. Fees were traditionally fixed at 0.50% of the fund's net assets. *See e.g.*, *Saxe v. Brady*, 40 Del. Ch. 474, 184 A.2d 602 (1962). Since § 36(b) has been added to the ICA, many mutual funds have set the adviser fees on a sliding scale which allows a reduction in the percentage rate as the assets of the fund reach specified plateaus. *See, e.g.*, *Weiss v. Temporary Investment Fund, Inc.*, 692 F.2d 928 (3d Cir. 1982). *But see, e.g.*, *Fox*, 692 F.2d at 250 (fixed rate set at 0.50% of net assets).

25. Comment, *supra* note 11, at 736. The mere existence of these contracts is a valuable asset to management. *Id.*

26. *Modesitt*, *supra* note 11, at 1260. With the exceptional growth of the mutual fund industry in the 1950's and 1960's, many adviser's fees became enormous. Comment, *supra* note 18, at 743 & n.73. The suits were brought under both the ICA and the common-law doctrine of corporate waste. Eisenberg & Lehr, *An Aspect of the Emerging "Federal Corporation Law" Directorial Responsibility Under the Investment Company Act of 1940*, 20 RUTGERS L. REV. 181, 204 (1966).

27. *See Acampora v. Birkland*, 220 F. Supp. 527, 549 (D. Colo. 1963) (advisory fee of 0.50% of net assets was not excessive because it was not "unconscionable and shocking" due to the fact that the services were incapable of evaluation); *Saxe v. Brady*, 40 Del. Ch. 474, 486, 184 A.2d 602, 610 (1962) (in suit based on corporate waste theory, payment of adviser fee of 0.50% of average daily net assets of the fund was reasonable and plaintiff shareholders who have ratified such an advisory contract must show that "what the corporation has received is so inadequate in value that no person of ordinary, sound business judgment would deem it worth what the corporation has paid"); *Meiselman v. Eberstadt*, 39 Del. Ch. 563, 568, 170 A.2d 720, 723 (1961) (no liability where majority of the fund's unaffiliated and unbiased directors and shareholders had approved the compensation agreement).

28. SEC, PUBLIC POLICY IMPLICATIONS OF INVESTMENT COMPANY GROWTH, H.R. REP. NO. 2337, 89th Cong., 2d Sess. 83 (1966) [hereinafter cited as PPI]. The SEC report was based on the findings of a study conducted by the securities research unit of the Wharton School of Finance and Commerce of the University of Pennsylvania. *Fox*, 692 F.2d at 257. The ICA authorized the SEC to commission studies involving the ramifications of further increases in the size of investment companies and how that might effect investors. Investment Company Act of 1940, § 14, 15 U.S.C. § 80a-14(b) (1982).

29. PPI, *supra* note 28, at 1. The SEC found that there was no competition among various advisers for the contracts with the mutual funds. *Id.* at 126-27. The SEC further found that the ICA requirement that shareholders ratify the advisory contract was inadequate to protect against excessive adviser fees. *Id.* at 130. Likewise, the ICA provision providing for shareholder election of fund directors was found to be ineffective. *Id.* at 129-31.

Pursuant to proposals contained in the SEC study,³⁰ the ninety-first Congress added section 36(b) to the ICA.³¹ Section 36(b) imposes on the investment adviser a fiduciary duty to the mutual fund regarding the amount of the management fees he can receive.³²

III. THE ISSUE: IS DEMAND REQUIRED IN AN ACTION UNDER SECTION 36(b)?

From the date of its enactment, section 36(b) has engendered litigation, the primary focus of which has been on the relationship between that section and Rule 23.1 of the Federal Rules of Civil Procedure.³³ Because the demand requirement of Rule 23.1 only applies when a shareholder attempts to "enforce a right which may properly be asserted" by the corporation,³⁴ the preliminary question of whether a mutual fund may properly assert a cause

30. *Id.* at 143-47. The SEC proposed a requirement that the fees be reasonable. *Id.* at 144. Although in § 36(b) of the ICA, as amended in 1970, the term "fiduciary duty" is substituted for "reasonable," one court has held this change to be "a more semantical than substantive compromise," designed only to shift the focus of the standard from the fund directors to the investment adviser. *Gartenberg v. Merrill Lynch Asset Management, Inc.*, 694 F.2d 923, 928 (2d Cir. 1982), *cert. denied*, 103 S. Ct. 1877 (1983).

31. Investment Company Act of 1940, § 36(b), 15 U.S.C. § 80a-35(b) (1981). For portions of the text of § 36(b), see notes 2 & 3, *supra*.

32. Investment Company Act of 1940, § 36(b), 15 U.S.C. 80a-35(b) (1982). The approach Congress took in drafting § 36(b) precludes the results reached in earlier cases where shareholders were denied relief on allegedly excessive fees due to director approval and shareholder ratification of the advisory contract, due to the fact that under § 36(b), director approval and shareholder ratification became only two of the factors to be considered by the court in determining the fairness of the adviser's fee. *Mutual Fund Amendments: Hearings on H.R. 11995, S. 2224, H.R. 13754 & H.R. 14737 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 91st Cong., 1st Sess. 188-89 (1969) (memorandum of Philip Loomis, General Counsel, SEC). For a discussion of these earlier cases, see note 27 and accompanying text, *supra*.

The standard applied to determine if there has been a breach of the fiduciary duty is "whether the fee schedule represents a charge within the range of what would have been negotiated at arm's-length in the light of all of the surrounding circumstances." *Gartenberg v. Merrill Lynch Asset Management, Inc.*, 694 F.2d 923, 928 (2d Cir. 1982), *cert. denied*, 103 S. Ct. 1877 (1983). Other factors in the court's determination of whether a fee is so excessive as to be a breach of fiduciary duty include the following: rates other investment advisers charge similar funds; the adviser's costs in providing the service; whether the adviser realizes economies of scale as the fund's assets expand; and the nature and quality of the services provided. *Id.* at 929-30. For a general discussion of the standard for imposing a fiduciary duty on an adviser with respect to their fees under § 36(b), see Comment, *Mutual Fund Advisory Fees—Too Much for Too Little?*, 48 *FORDHAM L. REV.* 530 (1980).

33. See, *Fox*, 692 F.2d at 250. *Weiss v. Temporary Investment Fund, Inc.*, 692 F.2d 928 (3d Cir. 1982); *Grossman v. Johnson*, 674 F.2d 115 (1st Cir.), *cert. denied*, 103 S. Ct. 85 (1982); *Blatt v. Dean Witter Reynolds Intercapital, Inc.*, 528 F. Supp. 1152 (S.D.N.Y. 1982); *Gartenberg v. Merrill Lynch Asset Management, Inc.*, 91 F.R.D. 524 (S.D.N.Y. 1981); *Markowitz v. Brody*, 90 F.R.D. 542 (S.D.N.Y. 1981); *Boyko v. Reserve Fund, Inc.*, 68 F.R.D. 692 (S.D.N.Y. 1975).

34. See *FED. R. CIV. P.* 23.1.

of action under section 36(b) is raised.³⁵

A. *The Mutual Fund and Section 36(b): Is There An Implied Cause of Action?*

Because section 36(b) does not explicitly authorize a suit by an investment company,³⁶ federal case law must be examined to determine whether it is proper to imply such a cause of action.³⁷ Where a federal statute fails to expressly provide a remedy, federal courts have often been called upon to imply remedies they deem are necessary to effect the Congressional purpose behind the statute.³⁸ In *Cort v. Ash*,³⁹ the Supreme Court established a four-part test to determine when an implied cause of action exists under a federal

35. For a discussion of whether a mutual fund may properly assert a cause of action under section 36(b), see notes 50-76 and accompanying text, *infra*.

36. See notes 2 & 3 and accompanying text, *supra*.

37. The first courts to construe section 36(b) held that the investment company was not granted an express cause of action, but failed to see the significance of this in light of Rule 23.1. See, e.g., *Boyko v. Reserve Fund, Inc.*, 68 F.R.D. 692, 694 (S.D.N.Y. 1975) (allegations of complaint were sufficient to excuse demand required by Rule 23.1).

38. *J.I. Case Co. v. Borak*, 377 U.S. 426, 433 (1964). See Mishkin, *The Variousness of "Federal Law": Competence and Discretion in the Choice of National and State Rules for Decision*, 105 U. PA. L. REV. 797 (1957); Note, *Implying Civil Remedies from Federal Regulatory Statutes*, 77 HARV. L. REV. 285 (1963). The first case to recognize an implied private cause of action under a federal statute was *Texas & Pacific Ry. v. Rigsby*, 241 U.S. 33 (1916). The Supreme Court in *Rigsby* implied a cause of action under the Federal Safety Appliance Acts. *Id.* at 40 (citing Federal Safety Appliance Act, Act of March 2, 1893, ch. 196, 27 Stat. 531 (1893) (current version at 45 U.S.C. § 1 et seq. (1976)). *Rigsby*, a railroad worker, was injured as a result of his employer's failure to provide the secure ladders required by the Act to be on all railroad cars. *Id.* at 36-37. Subsequent cases, however, have interpreted the Federal Safety Appliance Acts not to imply a private cause of action. See, e.g., *Moore v. Chesapeake & Ohio Ry.*, 291 U.S. 205 (1934); *Jacobson v. New York, N.H. & H.R. Co.*, 206 F.2d 153 (1st Cir. 1953), *aff'd*, 347 U.S. 909 (1954) (per curiam).

In *J.I. Case Co. v. Borak*, the Court observed that an implication of private federal actions would be proper in cases where such an action was both consistent with the intent of Congress in passing the statute and necessary to effectuate the purpose of the statute. 377 U.S. at 432-33. After noting this rule, the Court held that shareholders have an implied cause of action for violations of § 14(a) of the Securities Exchange Act. *Id.* The Court found that one of Congress' principle purposes in enacting § 14 was to protect the shareholders; that private enforcement of § 14 was necessary to supplement actions by the SEC; and that no adequate remedies were available to shareholders under existing state laws. *Id.* at 332-35. See Securities Exchange Act of 1934, § 14(a), 15 U.S.C. § 78n(a) (1982).

In the decade which followed *Borak* both the Supreme Court and the lower federal courts used the liberal standard of *Borak* to find implied rights of action under numerous federal statutes. See, e.g., Comment, *Implied Rights of Action in Federal Legislation: Harmonization Within the Statutory Scheme*, 1980 DUKE L.J. 928, 930 n.5.

39. 422 U.S. 66 (1975). In *Cort*, a shareholder of the Bethlehem Steel Corp. brought an action against that corporation and members of its board of directors seeking both injunctive and compensatory relief for violations of § 610 of the 1974 amendments to the Federal Elections Campaign Act. *Id.* at 71-72. For the text of § 610, see Federal Elections Campaign Act, § 610, 18 U.S.C. § 610 (repealed 1976). The statute, which prohibited the expenditure of corporate funds in connection with specified federal elections, provided only for criminal sanctions. 422 U.S. at 78.

statute.⁴⁰ Under the *Cort* standard, a court is to consider the following factors: 1) whether the plaintiff is a member of the class Congress intended to benefit by enacting the statute; 2) whether the legislative history of the statute indicates a Congressional intent to create or deny an implied private remedy; 3) whether implying a cause of action is consistent with the purpose of the statute; and 4) whether state law has traditionally regulated the area addressed by the statute.⁴¹

The Supreme Court subsequently invoked the *Cort* test to deny implied causes of action under a number of federal statutes.⁴² Several courts of appeals, however, continued to imply private rights of action under federal statutes despite the *Cort* test's limitations.⁴³

In *Touche Ross & Co. v. Redington*,⁴⁴ and *Transamerica Mortgage Advisors, Inc. v. Lewis*,⁴⁵ the United States Supreme Court further narrowed the avail-

40. 422 U.S. at 78. The test was more restrictive than earlier standards used to determine whether an implied right of action was proper and was intended to limit the imposition of private rights of action. See McMahon & Rodos, *Judicial Implication of Private Causes of Action: Reappraisal and Retrenchment*, 80 DICK. L. REV. 167, 183 (1975); Pillai, *Negative Implication: The Demise of Private Rights of Action in the Federal Courts*, 47 U. CIN. L. REV. 1, 21 (1978).

41. 422 U.S. at 78. Applying these four factors, the Court determined that: 1) the statute was not enacted for the benefit of Bethlehem Steel's shareholders; 2) the primary purpose of the statute, the elimination of corporate influence over the outcome in Federal elections, was not furthered by the implication of a private right of action; and 3) the internal affairs of the corporation are traditionally determined pursuant to state law. *Id.* at 81-85. The Court, therefore, concluded that no implied private right of action could exist under § 610. *Id.* at 85.

42. *E.g.*, *Chrysler Corp. v. Brown*, 441 U.S. 281 (1979) (no implied right of action under the Freedom of Information Act); *Santa Clara Pueblo v. Martinez*, 436 U.S. 49 (1978) (no private right of action under Title I of the Indian Civil Rights Act of 1968); *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1 (1977) (no private right of action under § 14(e) of the Securities Exchange Act of 1934).

43. See *Cannon v. University of Chicago*, 441 U.S. 677, 741 (1979) (Powell, J., dissenting). Justice Powell in his dissent in *Cannon* referred to twenty circuit courts' decisions in which the *Cort* factors had been used to imply a private cause of action, and concluded that "[i]t defies reason to believe that in each of these statutes Congress absentmindedly forgot to mention an intended private action." *Id.* at 742 (Powell, J., dissenting). Justice Powell expressed dissatisfaction with the four factor *Cort* test because only the second factor required an examination of Congressional intent, while the other three factors "invite[d] independent judicial lawmaking." *Id.* at 740 (Powell, J., dissenting).

44. 442 U.S. 560 (1979). In *Touche Ross*, the court-appointed trustee for the insolvent securities brokerage firm, Weis Securities, Inc. (Weis), brought an action against Touche Ross & Co. (Touche Ross), Weis' certified public accountant from 1969 to 1973. *Id.* at 563. The trustee alleged that Touche Ross had improperly audited and certified Weis' books and records and further that the reports Weis had prepared for the SEC as required by § 17(a) and Rule 17a-5 promulgated thereunder were therefore inaccurate. *Id.* at 563-65. For the text of Rule 17a-5, see 17 C.F.R. § 240.17a-5 (1980). The trustee further claimed that Touche Ross' actions violated § 17(a) and prevented the disclosure of Weis' true financial condition until liquidation of the brokerage firm became imminent. 442 U.S. at 565-66. The Court found no private cause of action could be implied from § 17a. *Id.* at 569-71. For the content of § 17(a), see Securities Exchange Act of 1934, § 17(a), 15 U.S.C. § 78q (1982).

45. 444 U.S. 11 (1979). In *Transamerica*, a shareholder of a real estate investment

ability of implied rights of action under federal statutes, holding that only the second *Cort* factor, congressional intent, is relevant, and that no cause of action can be implied absent the presence of such intent in the statutory scheme or the statute's legislative history.⁴⁶ In *Middlesex County Sewerage Authority v. Sea Clammers Association*,⁴⁷ the Supreme Court again expressed its intention to limit the availability of the implied cause of action.⁴⁸ The *Sea Clammers* Court concluded that the existence of elaborate enforcement provisions in a federal statute would, without "strong indicia of a contrary congressional intent," indicate that no implied cause of action was intended.⁴⁹

trust brought an action against certain trustees alleging violations of §§ 206 and 215 of the Investment Adviser's Act of 1940. *Id.* at 13-17. The Court allowed the plaintiffs to pursue their claim under § 215 seeking rescission of the investment contract, an injunction against enforcement of the contract, and restitution. *Id.* at 19. The Court believed that Congress must have intended to recognize those customary legal incidents which would necessarily follow from Congress' declaration in § 215 that all contracts which were in violation of the Act were void. *Id.* The Court, however, found that no private right of action exists under § 206 of the Investment Adviser's Act. For the content of §§ 206 and 215, see Investment Adviser's Act of 1940, §§ 206, 215, 15 U.S.C. §§ 80b-6, 80b-15 (1982).

46. *Touche Ross*, 442 U.S. at 575-76; *Transamerica*, 444 U.S. at 15-16, 23-24. In *Transamerica*, Justice Stewart, writing for the majority, emphasized that the existence of an implied cause of action turns on statutory construction and not on the desirability of providing remedies which the courts think will best effectuate the purpose of the statute. 444 U.S. at 15. In both cases, the Court found the legislative history to be silent as to Congress' actual intent. *Id.* at 18; 442 U.S. at 571. The *Transamerica* Court admitted that silence alone would not "automatically undermine" an implied cause of action, but stated that such silence was "hardly helpful." 444 U.S. at 18. The Court further stated that silence would create a presumption that no private cause of action was intended unless the "language or structure of the statute" or the "circumstances of its enactment" suggested otherwise. *Id.* *Touche Ross* and *Transamerica* relegated the remaining factors of the *Cort* test to use in the determination of Congressional intent. 442 U.S. at 575-76; 444 U.S. at 15-16, 23-24.

47. 453 U.S. 1 (1981).

48. *Id.* In *Sea Clammers*, a group of fishermen brought an action seeking injunctive relief and damages against various governmental entities for injuries allegedly caused by the dumping of sewage sludge into the ocean. *Id.* at 5-6. The plaintiff argued that there was an implied right of action under the Federal Water Pollution Control Act of 1948 and the Marine Protection, Research and Sanctuaries Act of 1972. *Id.* at 10-11. For the respective provisions of these acts, see 33 U.S.C. §§ 1251-1376 and 1401-1444 (1976). The Court noted that the statutes specifically conferred authority on government officials and private citizens to enforce the act by means of an injunction or the imposition of civil or criminal penalties. 453 U.S. at 13-14. After noting the existence of this language, the Court stated as follows:

In view of these elaborate enforcement provisions it cannot be assumed that Congress intended to authorize by implication additional judicial remedies for private citizens In the absence of strong indicia of a contrary congressional intent, we are compelled to conclude that Congress provided precisely the remedies it considered appropriate.

Id. at 14-15.

49. 453 U.S. at 15. *Sea Clammers* was one of five cases heard by the Supreme Court in 1981 which involved implied rights of action; in all five opinions the justices refused to imply a private right of action under the federal statute in question. *See id.*; *Texas Indus., Inc. v. Radcliff Materials, Inc.*, 451 U.S. 630 (1981) (no private right of action under Sherman or Clayton Acts); *California v. Sierra Club*, 451 U.S.

Recently, the specific question of whether an investment company has an implied cause of action under section 36(b) has been thoroughly analyzed by three circuit courts of appeals.⁵⁰ In *Grossman v. Johnson*,⁵¹ the First Circuit concluded that there exists an implied cause of action under section 36(b).⁵² In reaching its result, the court of appeals stressed that it could not believe that an independent board of directors would be precluded from recovering excessive fees from the investment advisor.⁵³ The court opined that "Congress could well have believed that . . . it was unnecessary to say with particularity that the investment company would have a cause of action."⁵⁴

In *Weiss v. Temporary Investment Fund, Inc.*,⁵⁵ the Third Circuit similarly

287 (1981) (no right of action under § 10 of the Rivers and Harbours Appropriation Act of 1899); *Northwest Airlines, Inc. v. Transport Workers Union*, 451 U.S. 77 (1981) (no private right of action under the Equal Pay Act of 1963); *Universities Research Ass'n v. Coudu*, 450 U.S. 754 (1981) (no private right of action under Davis-Bacon Act of 1931).

The Supreme Court has, however, carved out an exception to the line of cases limiting implied rights of action. *See Herman & MacLean v. Huddleston*, 103 S. Ct. 683 (1983); *Merrill Lynch, Pierce, Fenner & Smith v. Curran*, 456 U.S. 353 (1982). In *Curran*, the Supreme Court was asked to determine whether implied rights of action under the Commodity Exchange Act had survived the passage of significant amendments to the Act in which Congress failed to codify the implied rights of action. 456 U.S. at 374. The *Curran* Court held that since "Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change," that such silence indicates that Congress intended to retain the implied statutory rights of action created by the courts. *Id.* at 382, n. 66.

In *Huddleston*, the Court held that an implied right of action existed under § 10(b) of the Securities Exchange Act of 1934, even though express rights of action were available to the plaintiff under § 11 of the Securities Act of 1933. 103 S. Ct. at 689. The Court based its decision, at least in part, on the fact that "when Congress comprehensively revised the securities laws in 1975, a consistent line of judicial decisions had permitted plaintiffs to sue under Section 10(b) regardless of the availability of express remedies." *Id.*

50. *See Weiss v. Temporary Investment Fund, Inc.*, 692 F.2d 928 (3d Cir. 1982) (finding implied cause of action); *Fox*, 692 F.2d at 250 (finding no implied cause of action); *Grossman v. Johnson*, 674 F.2d 115 (1st Cir.), *cert. denied*, 103 S. Ct. 85 (1982) (finding implied cause of action).

51. 674 F.2d 115 (1st Cir.), *cert. denied*, 103 S. Ct. 85 (1982).

52. *Id.* at 120.

53. *Id.*

54. *Id.* The *Grossman* court cited two additional factors in support of its conclusion that an investment company has an implied private right of action under § 36(b). First, the court found that the statute states that any recovery is to be "on behalf of such company," language traditionally implying the action is derivative in nature. *Id.* Second, the court noted that the plaintiff had brought the action under the assumption that it was derivative in nature. *Id.*

55. 692 F.2d 928 (3d Cir. 1982). On May 7, 1980, Weiss, as custodian for his minor son, brought a shareholder suit on behalf of the Temporary Investment Fund, Inc., against Provident Institutional Management Corporation, the fund's adviser, Shearson Loeb Rhoads, Inc., the fund's underwriter, and all seven members of the fund's board of directors. *Id.* at 931. Weiss charged the defendants with breach of the fiduciary duties imposed on them by § 36(b). *Id.* at 931-32. The adviser's contract in question failed to provide for reduction in fees to the adviser after the fund's

held that an implied cause of action exists under section 36(b).⁵⁶ The Third Circuit, however, went beyond the First Circuit's analysis and examined section 36(b) in light of the four-factor test enunciated by the Supreme Court in *Cort*.⁵⁷ Examining each of the factors in the *Cort* test, the Third Circuit found: (1) the investment company was the intended beneficiary of section 36(b);⁵⁸ (2) Congress' silence implied that the corporation was intended to have a cause of action even though there was no explicit evidence of such an intent in the legislative history;⁵⁹ (3) a cause of action by the corporation is consistent with the underlying purpose of section 36(b);⁶⁰ and (4) an implied cause of action would not interfere with an area of law "traditionally relegated to state law."⁶¹

Dissenting in *Weiss*, Judge Gibbons disagreed that the *Cort* test was the proper test to apply.⁶² He noted that subsequent Supreme Court cases had severely limited the implication doctrine,⁶³ requiring a "clear indication of congressional intent" to imply a cause of action under a federal statute.⁶⁴

assets reached a certain level. For a discussion of implied causes of action, see notes 44-57 and accompanying text *supra*.

56. 692 F.2d at 934-36.

57. *Id.* The court acknowledged the First Circuit's opinion in *Grossman*, but found the support for that court's holding to be too limited. 692 F.2d at 934. The *Weiss* court also emphasized that the Supreme Court has used the language "derivative suit" in describing an action under § 36(b), thereby implying that the corporation was to have an implied cause of action. 692 F.2d at 934 (citing *Burks v Lasker*, 441 U.S. 471 (1979)). For a discussion of *Burks*, see note 81 and accompanying text *infra*.

58. 692 F.2d at 935. The court noted that "any recovery obtained in a shareholder suit reverts to the investment company." *Id.*

59. *Id.* The court acknowledged that legislative intent is the principal focus of the *Cort* test. *Id.* (citations omitted). The *Weiss* court believed that an absence of an express authorization of an implied cause of action was to be expected because the statute "does not purport to be the source of authority for managerial power; rather, the Act functions primarily to 'impos[e] controls and restrictions on the internal management of investment companies.'" *Id.* (quoting *Burks v. Lasker*, 441 U.S. 471, 478 (1979)) (emphasis in original).

60. 692 F.2d at 936. The *Weiss* court believed that the statute could be more effectively enforced by a corporation than by a shareholder due to the corporation's intimate knowledge of the adviser-fee contract and its superior financial resources. *Id.*

61. *Id.* The court believed that the grant of an express cause of action to the shareholders "federalized this type of litigation," and made a companion remedy for the investment company logically acceptable. *Id.*

62. *Id.* at 953. (Gibbons, J., dissenting).

63. *Id.* (citing *Texas Indus., Inc. v. Radcliff Materials, Inc.*, 451 U.S. 630, 639 (1981); *Middlesex County Sewerage Auth. v. National Sea Clammers Ass'n*, 453 U.S. 1, 13 (1981)). For a discussion of the implication doctrine, see notes 46-57 and accompanying text *supra*. The commentators agree that cases following *Cort* have limited the availability of an implied cause of action. See Note, *A New Direction for Implied Causes of Action*, 48 *FORDHAM L. REV.* 505 (1980).

64. 692 F.2d at 953 (Gibbons, J., dissenting). Judge Gibbons also disagreed with the majority's analysis of the legislative history of § 36(b). He found evidence in the legislative history which shows that Congress thought fund directors could not deal effectively with the problems of adviser fees because of the nature of the mutual

Consistent with this interpretation of Supreme Court precedent, Judge Gibbons felt the corporation could not assert a section 36(b) action.⁶⁵

Contemporaneous with the *Weiss* opinion, the Court of Appeals for the Second Circuit, in *Fox v. Reich & Tang, Inc.*,⁶⁶ held that an investment company does not have an implied cause of action under section 36(b).⁶⁷ The Second Circuit first examined the language of the ICA and found no express authorization for a direct suit by an investment company.⁶⁸ It rejected the notion that the use of the words “on behalf of such company” in section 36(b) implied that the action was meant to be derivative.⁶⁹ Furthermore, the *Fox* court could not agree that because the plaintiffs had characterized their action under section 36(b) as a “derivative” action, an implied cause of action for the corporation necessarily followed.⁷⁰ In light of the “specific and elaborate enforcement provision” in section 36(b) which authorizes both the SEC and the security-holders of the investment company to enforce its requirements,⁷¹ the court stated that it would “not lightly assume an unexpressed intention to create additional” remedies.⁷² Finally, the Second Circuit searched the legislative history of section 36(b) for evidence of a con-

fund industry and its inherent conflict of interest. *Id.* at 951 (Gibbons, J. dissenting). He maintained that a suit litigated by the fund, or a consent decree negotiated by the fund, would preclude judicial review of fee levels. *Id.* at 950-51 (Gibbons, J., dissenting). He concluded that Congress could not have intended to create a private cause of action in light of the specific provision for judicial review set forth in § 36(b)(2). *Id.*

65. *Id.* at 953 (Gibbons, J., dissenting).

66. 692 F.2d 250 (2d Cir. 1982), *cert. granted*, 103 S. Ct. 1271 (1983).

67. *Id.* at 261. Martin Fox, a shareholder of Daily Income Fund, Inc. (“Fund”) filed an action against the Fund’s investment adviser Reich & Tang, Inc. (R & T), alleging it had been paid excessive fees in violation of § 36(b). *Id.* at 252. R & T then joined the Fund as a defendant. *Id.* The fees R & T had been paid for its investment advice were set at a fixed rate of one-half of one per cent of the Fund’s net assets and were not reduced despite an increase in Fund assets from approximately \$75 million in 1978 to \$775 million in 1981. *Id.* This increase in net assets resulted in an increase in the fees paid to R & T from approximately \$375,000 in 1978, to close to \$4 million in 1981. *Id.* at 253.

68. 692 F.2d at 254-55. The *Fox* court’s reasoning followed Judge Gibbons’ dissenting opinion in *Weiss*, and held that the proper standard for the creation of an implied cause of action was the “clearly expressed congressional intent” test set forth in *Sea Clammers*. *Id.* at 255 (citing *Sea Clammers*, 453 U.S. at 13-15 (1981)). For a discussion of Judge Gibbons’ dissenting opinion in *Weiss*, see notes 62-65 and accompanying text *supra*.

69. 692 F.2d at 255. The court noted that, normally, when Congress intends to provide a corporation with a right to sue, it does so expressly. *Id.* at 255-56. From this express provision the shareholders’ derivative right of action would follow automatically. *Id.*

70. *Id.* The court found it hard to “understand how a defect in a pleading—or a misreading of § 36(b)—[could] take precedence over the clear dictates of a statute.” *Id.* at 256.

71. Investment Company Act of 1940, § 36(b), 15 U.S.C. § 80a-35(b) (1982). For the text of this provision, see note 36 *supra*.

72. 692 F.2d at 255 (citing *Sea Clammers*, 453 U.S. at 13-15). For a discussion of *Sea Clammers*, see notes 47-49 and accompanying text *supra*.

gressional intent to imply a private cause of action.⁷³ Finding that the problem of excessive adviser fees is “basically incompatible with a corporate right of action as an effective solution,”⁷⁴ the court explained that the sole purpose of the 1970 amendments was to facilitate shareholder derivative suits under the Act.⁷⁵ Concluding that nothing in the legislative history indicated a contrary intent, the *Fox* court refused to imply a corporate cause of action under the statute.⁷⁶

B. *The Interaction of Section 36(b) Suits and Normal Demand Requirements*

Assuming that an investment company may properly assert a cause of action under section 36(b), thereby triggering the requirements of Rule 23.1,⁷⁷ a second issue which must be resolved is whether section 36(b) was intended by Congress to require a demand by the shareholders of an investment company as a prerequisite to commencing suit. Several distinct arguments for not requiring a demand have been advanced by plaintiffs who have brought actions under section 36(b). First, it has been argued that the legislative history of section 36(b) reveals a congressional intent to exempt an action under that section from the requirements of Rule 23.1.⁷⁸ This argu-

73. 692 F.2d at 256-61. The *Fox* court was bound by the Supreme Court's requirement in *Transamerica* that a court search for persuasive evidence of a legislative intent contrary to the statute's silence on the issue of an implied right of action. For a discussion of *Transamerica*, see notes 45 & 46 and accompanying text *supra*.

74. 692 F.2d at 259. While the court acknowledged that Congress had intended that independent directors act as “watchdogs” with respect to adviser fees, it found that it “defies logic to conclude their contemplated role included suing their advisers.” *Id.*

75. *Id.* at 260-61. The court observed that Congress, in amending the Investment Company Act, was concerned not with the possibility of a suit by the fund, but with “how to particularize the already existing statute to make judicial relief a genuine possibility” for the shareholder of the fund. *Id.* For a discussion of the problems shareholders encountered bringing suits to challenge excessive adviser fees prior to the 1970 amendments, see notes 26-28 and accompanying text *supra*.

76. 692 F.2d at 261. The court held that Rule 23.1 is never triggered and no demand can be required in an action under § 36(b). *Id.*

77. For a discussion of the demand requirement of Rule 23.1 of the Federal Rules of Civil Procedure, see note 5 *supra*.

78. See, e.g., *Grossman v. Johnson*, 674 F.2d at 121. Recognizing the legislative history's “emphasis on the prior ineffectiveness of independent directors with respect to advisory fees, the need for strengthening then section 36, and the significant role of the courts in determining the proper level of fees,” the *Grossman* court found these considerations consistent with requiring a demand pursuant to Rule 23.1. 674 F.2d at 121-22 (citing FED. R. CIV. P. 23.1). The court also observed that there is language in the legislative history referring to both the need to do away with “procedural obstacles” and the need to provide “sufficient safeguards against frivolous or harassing law suits.” *Id.* at 122 (quoting *Mutual Fund Amendments: Hearings on H.R. 11995, S. 2224, H.R. 13754 & H.R. 14737 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce, 91st Cong., 1st Sess. 860 (1969); Investment Company Act Amendments Act of 1969: Hearings on S. 34 and S. 296 Before the Senate Comm. on Banking and Currency, 91st Cong. 1st Sess. 30 (1969)*).

Other courts to have considered this argument have similarly rejected it. See, e.g., *Weiss*, 692 F.2d at 936-38. The *Weiss* court found that “the legislative history

ment has not yet been accepted by any court⁷⁹ because the Federal Rules of Civil Procedure are presumed to apply to any federal statute⁸⁰ except where Congress provides otherwise.

Based on dicta found in the Supreme Court's decision in *Burks v. Lasker*,⁸¹ plaintiffs have also argued that requiring a demand would serve no public purpose since a corporation's board of directors is precluded from terminating a section 36(b) suit through the exercise of their "business judgment."⁸² While other circuits have disagreed, the Second Circuit has stated that, in light of the Supreme Court's dicta in *Burks*, "the traditional reason for the demand requirement simply does not apply."⁸³ The First and Third

reflects an implicit understanding that Rule 23.1 would apply." *Id.* at 938 (citing FED. R. CIV. P. 23.1). The *Weiss* court further found that demand was consistent with the unaffiliated director's "watchdog" role. *Id.* For a discussion of the Third Circuit's decision in *Weiss*, see notes 55-61 and accompanying text *supra*.

79. See *Weiss*, 692 F.2d at 936 (citations omitted). For a discussion of the court's alternative reasoning for rejecting this contention, see note 78 *supra*.

80. See FED. R. CIV. P. 1; 28 U.S.C. § 2072 (1982).

81. 441 U.S. 471 (1979). In *Burks*, shareholders of a mutual fund brought an action against the fund's investment adviser and several of its directors, charging them with the negligent purchase of \$20 million in Penn Central 270-day commercial paper without first inquiring into the financial stability of that company. *Id.* at 473-74 & n.3. Soon thereafter, Penn Central filed a petition for reorganization under the Bankruptcy Act, resulting in the commercial paper's failure to reach maturity. *Id.* at 474. A special committee of directors unaffiliated with the investment adviser was appointed to review the suit. *Id.* This independent committee sought dismissal of the suit, determining, with the help of outside counsel, that the suit was not in the best interests of either the fund or its shareholders. *Id.* The Court held that even when the cause of action is federal, the courts must look to the state's business judgment rule to determine whether an independent board of directors can terminate a shareholder suit. *Id.* at 486. The Court, however, noted that the federal courts only must apply the state's business judgment rule when termination is consistent with the policy of the federal statute in issue. *Id.* The *Burks* Court cited § 36(b) as an example of when termination is inconsistent with the policies of a federal statute. *Id.* at 484. The Court stated, "[W]hen Congress [intended] to prevent board action from cutting off derivative suits, it said so expressly. Section 36(b) . . . performs precisely this function for derivative suits charging breach of fiduciary duty with respect to adviser's fees." *Id.*

82. See, e.g., *Weiss*, 692 F.2d at 939; *Fox*, 692 F.2d at 261; *Grossman*, 674 F.2d at 121.

83. *Fox*, 692 F.2d at 261. The Second Circuit believed that the traditional reason for requiring demand before resorting to court interference in the internal affairs of a private corporation could not be furthered in an action under § 36(b) because the directors could neither take charge of the action themselves nor terminate the suit. *Id.* (citing Comment, *supra* note 1, at 171-72).

Judge Gibbons, in his dissenting opinion in *Weiss*, agreed with, and elaborated upon, the Second Circuit's reasoning in *Fox*. *Weiss*, 692 F.2d at 952-53 (Gibbons, J., dissenting). Noting that the Second Circuit carries "particular authority" in cases involving securities law, Judge Gibbons pointed out that the statute expressly provides that the directors' views be given only "such consideration . . . deemed appropriate under all the circumstances." *Id.* at 952 (Gibbons, J., dissenting) (quoting 15 U.S.C. § 80a-35(b)(2) (1976)). He contended that to require demand would be to serve no purpose other than to allow the directors to delay the suit. *Id.* Because § 36(b) imposes a short statute of limitations on the period for which excessive fees may be recovered, delay is especially harmful to plaintiffs. For a discussion of the

Circuits, however, have held that, notwithstanding the *dicta* present in *Burks*, other legitimate corporate purposes are served by requiring demand.⁸⁴

A third argument proffered by shareholder-plaintiffs compares section 36(b) of the ICA with section 16(b) of the Securities Exchange Act of 1934 which has been found by the courts not to be subject to Rule 23.1.⁸⁵ Both sections, it has been argued, are "instruments of public policy which should not be hampered by procedural restrictions."⁸⁶ Further, it is asserted that a cause of action under either statute should not be terminable by a decision of the board of directors.⁸⁷ The courts that have addressed this argument have

problem imposed by the statute of limitations in § 36(b), see notes 100-103 and accompanying text *infra*. For a further discussion of Judge Gibbons' dissenting opinion in *Weiss*, see notes 62-65 and accompanying text *supra*.

84. See, e.g., *Grossman*, 674 F.2d at 121; *Weiss*, 692 F.2d at 941-42. The *Grossman* court, while recognizing that the statute could easily be read to place the ultimate power to decide the excessiveness of adviser fees in the courts, concluded that demand could still play an important role. 674 F.2d at 121. The Third Circuit, in *Weiss*, elaborated on the alternative remedies which the board of directors might pursue even if they are not able to terminate a shareholder suit. *Weiss*, 692 F.2d at 941-42. For example, the *Weiss* court observed that the 1970 amendment to the ICA allows the directors to terminate the investment adviser contract with sixty-days notice. *Id.* at 942. The court also held that the directors could negotiate with the adviser for a rebate of the excessive fees, satisfy the shareholder that the fees are reasonable or that the litigation is not in the shareholder's best interest, or even take control of the suit themselves. *Id.* at 942 & n. 16. The plaintiff in *Weiss* had argued that *Burks* stood for the proposition that the directors of a mutual fund are always too interested to terminate a suit challenging the adviser fees. *Weiss*, 692 F.2d at 940. The plaintiff in *Weiss* then argued that since the standard for termination and demand are the same, demand should always be excused. *Id.* The *Weiss* court found the plaintiff's argument "superficially alluring . . . [but] ultimately unpersuasive." *Id.* at 940. The court distinguished *Lewis v. Curtis*, a Third Circuit case the Second Circuit had cited in support of their acceptance of this argument. *Id.* (citing *Lewis v. Curtis*, 671 F.2d 779 (3d Cir. 1982)). In *Lewis*, the Third Circuit had found that the standard used by a court in determining whether the disinterested directors may use their "business judgment" to terminate a suit is also the same standard as that used by the court to determine whether a demand will be presumed futile. *Lewis v. Curtis*, 671 F.2d 779, 785-86 (3d Cir. 1982).

There is only one reported case in which the *Burks* decision has been used to preclude a mutual fund's board of directors from using their business judgement to terminate a § 36(b) action. In *Evangelist v. Fidelity Management & Research Co.*, the District Court for the District of Massachusetts refused to dismiss a claim brought under § 36(b) where the trustees of a Massachusetts business trust registered under the ICA refused to sue on behalf of the fund after demand was made by a shareholder. *Evangelist v. Fidelity Management & Research Co.*, No. 81-536-2, Slip Op. at 3-9 (D. Mass., December 6, 1982), leave to app. denied, — F.2d — (1st Cir. January 21, 1983). For a discussion of *Burks*, see note 81 *supra*.

85. See *Grossman*, 674 F.2d at 120. Courts have found that § 16(b) of the 1934 Act, which allows security-holders to recover "short swing" profits by insiders, is exempt from the requirements of Rule 23.1. See, e.g., *Dottenheim v. Murchison*, 227 F.2d 737, 740 (5th Cir. 1955), *cert. denied*, 351 U.S. 919 (1957) (suits brought under § 16(b) exempt from contemporaneous ownership requirements of Rule 23.1). For the text of § 16(b), see Securities Exchange Act of 1934, § 16(b), 15 U.S.C. § 78p(b) (1982). For the text of Rule 23.1, see note 5 *supra*.

86. *Weiss*, 692 F.2d at 938-39.

87. See *Burks*, 441 U.S. at 484 n.13.

rejected it, distinguishing section 36(b) from section 16(b) on the grounds that the latter is subject to its own demand requirement and is therefore exempt from the general requirements of Rule 23.1.⁸⁸

Another argument which has been raised against a demand requirement is grounded on the fact that section 36(b) uses the language "security holder"⁸⁹ while Rule 23.1 utilizes the term "shareholder."⁹⁰ Advocates of this position contend that this semantic distinction should allow suits under section 36(b) by pure debenture-holders and other bare creditors who cannot comply with the requirements of Rule 23.1.⁹¹ In *Grossman*, the only case to address this contention, the First Circuit rejected this argument because it determined that Congress intended the terms be used synonymously.⁹²

Finally, some courts have found that the one-year statute of limitation which applies to damages recovered under section 36(b) is sufficient reason to excuse demand altogether.⁹³ The circuits which have accepted this argument have held that the one-year limitation provision in section 36(b) is incompatible with the normal delays incident to corporate decision-making because in an action brought under section 36(b), the consequences of such delay could be "severe."⁹⁴ Other courts, however, have disagreed, holding that demand should be required since in most cases recovery would not be reduced by any delay caused by the demand.⁹⁵ Furthermore, in those cases where demand would present an undue hardship, a court could allow the suit to go forward after a limited time if the directors could be shown to be causing "undue delay."⁹⁶

C. *The Demand Requirement and Section 36(b): A Presumption of Futility*

Even in situations where section 36(b) may require a demand, Rule 23.1 allows a plaintiff to avoid demand by demonstrating that its requirement

88. See *Weiss*, 692 F.2d at 938-39; *Grossman*, 674 F.2d at 120. Section 16(b) allows the shareholder to bring an action only if "the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter" Securities Exchange Act of 1934, § 16(b), 15 U.S.C. § 78p(b) (1982).

89. Investment Company Act of 1940, § 36(b), 15 U.S.C. § 80a-35(b) (1976). For the text of § 36(b) see notes 2 & 3 and accompanying text *supra*.

90. FED. R. CIV. P. 23.1. For the text of Rule 23.1, see note 5 *supra*.

91. See *Grossman*, 674 F.2d at 121.

92. *Id.* (citations omitted). The court pointed out that the term "shareholder" was used throughout the legislative history of § 36(b). *Id.*

93. See, e.g., *id.* at 122; *Blatt v. Dean Witter Reynolds Intercapital, Inc.*, 528 F. Supp. 1152, 1156 (S.D.N.Y. 1982). § 36(b)(3) provides that "[n]o award of damages shall be recoverable for any period prior to one year before the action was instituted." Investment Company Act of 1940, § 36(b), 15 U.S.C. § 80a-35(b)(3) (1982).

94. See *Weiss*, 692 F.2d at 951 (Gibbons, J., dissenting). See also *Fox*, 692 F.2d at 261-62; *Blatt v. Dean Witter Reynolds Intercapital, Inc.*, 528 F. Supp. 1152, 1156 (S.D.N.Y. 1982).

95. *Weiss*, 692 F.2d at 938.

96. *Grossman*, 674 F.2d at 122.

would be futile.⁹⁷ It has been successfully argued that, due to the nature of the relationship between the board of directors of a mutual fund and the investment adviser,⁹⁸ demand should always be presumed futile. Consequently, the pleading requirements of Rule 23.1 are satisfied by general allegations that the mutual fund's board of directors was under the control of the investment adviser.⁹⁹ In *Boyko v. Reserve Fund, Inc.*,¹⁰⁰ the first case to address this issue, the United States District Court for the Southern District of New York recognized that, under traditional demand requirements, such general allegations of improper influence would not be sufficient.¹⁰¹ However, concluding that section 36(b) was a "new type of derivative action," the court went on to hold that demand will be *presumed* futile in a section

97. FED. R. CIV. P. 23.1.

98. For a discussion of the mutual fund-investment adviser relationship, see notes 22-25 and accompanying text, *supra*.

99. See *Boyko v. Reserve Fund, Inc.*, 68 F.R.D. 692, 694 (S.D.N.Y. 1975). This argument has also been recently advanced by other § 36(b) plaintiffs. See, e.g., *Fox*, 692 F.2d at 261; *Weiss*, 692 F.2d at 943; *Grossman*, 674 F.2d at 115.

100. 68 F.R.D. 692 (S.D.N.Y. 1975). In *Boyko*, a shareholder of Reserve Fund, Inc. ("Fund") brought an action against the Fund and its investment adviser, Reserve Management Corporation, alleging that the compensation paid under the adviser-fee contract had become "excessive and unreasonable in the light of the mushrooming growth of the Fund assets and the minimum number of investment decisions and volume of advice required from the manager to keep said assets invested in the many market instruments utilized by the Fund." *Id.* at 693. The defendants moved to dismiss the complaint for failure to comply with the requirements of Rule 23.1. *Id.* at 694. The complaint admitted that no demand had been made, but alleged that two of the Fund's directors were also directors of the investment adviser, owned all of its stock, and that the Fund's board of directors was controlled by the investment adviser. *Id.*

101. *Id.* at 696. The court noted that in a normal derivative action, mere conclusory allegations of bias and self-interest on the part of the corporate directors, absent specific factual underpinnings, would not be sufficient to excuse demand. *Id.* at 694.

The *Boyko* court distinguished an earlier First Circuit case in which the court had determined that similar allegations, in a complaint charging a conspiracy to fix adviser fees in violation of antitrust laws, were insufficient to excuse demand finding that that action had been brought before the enactment of § 36(b). *Boyko*, 68 F.R.D. at 696 (citing *In re Kauffman Mutual Fund Actions*, 479 F.2d 257, 264-65 (1st Cir.), *cert. denied*, 414 U.S. 857 (1973)). But see *Galfand v. Chestnutt*, 402 F. Supp. 1318 (S.D.N.Y. 1975), *aff'd*, 545 F.2d 807, 808 (2d Cir. 1976), *cert. denied*, 435 U.S. 943 (1978) (demand excused where defendant-directors of a mutual fund had already "tenaciously and effectively" resisted plaintiffs previous attempts to enjoin a shareholder meeting at which a new adviser contract was ratified).

The circuits do not agree on the standards to be applied in determining whether the demand requirement should be excused. 3B J. MOORE, MOORE'S FEDERAL PRACTICE 23.1.19, 254 (2d ed. 1975). See also *Abbe v. Gross*, 411 F. Supp. 923, 924 (S.D.N.Y. 1975). While some circuits will allow unsupported allegations of control to excuse demand, most require specific factual allegations in the pleadings. Compare *de Haas v. Empire Petroleum Co.*, 286 F. Supp. 809 (D. Colo. 1968), *aff'd*, 435 F.2d 1223 (10th Cir. 1970) (general allegation of control sufficient to excuse demand) with *In re Kauffman Mutual Fund Actions*, 479 F.2d 257 (1st Cir.), *cert. denied*, 414 U.S. 857 (1973) and *Jones v. Equitable Life Assurance Society*, 409 F. Supp. 370 (S.D.N.Y. 1975) (requiring specific factual allegations of control).

36(b) suit whenever it has been alleged that there are one or more directors on the mutual fund's board who are affiliated with the investment adviser.¹⁰² Although the *Boyko* decision has never been overruled, it has not been followed in the other circuits.¹⁰³

IV. AN ANALYSIS OF THE DEMAND REQUIREMENT AND SECTION 36(b) IN LIGHT OF THE SUPREME COURT'S PRONOUNCEMENTS ON THE AVAILABILITY OF IMPLIED RIGHTS OF ACTION

Three separate questions have been raised by litigants and addressed by the courts regarding the relationship between the demand requirement and section 36(b):¹⁰⁴ first, does the investment company have an implied right of action under section 36(b) thereby triggering the demand requirement; second, did Congress intend the demand requirement be applied to section 36(b); and finally, should demand always be presumed futile in a section 36(b) suit. It is submitted, however, that the proper resolution of the first and threshold issue of whether the mutual fund itself may bring a private action under section 36(b) would render the resolution of the two remaining issues unnecessary.¹⁰⁵ It is further submitted that the most recent Supreme

102. *Boyko*, 68 F.R.D. at 696. The *Boyko* court held that "affiliated" meant "interested person" as that term is defined in § 2(a)(19) of the Act. *Id.* (citing Investment Company Act of 1940, § 2(a)(19), 15 U.S.C. § 80a-2(a)(19) (1976)). The court stated that the control which an adviser asserts over a mutual fund is a result of the nature of the industry and intangible factors which could not specifically be pleaded. 68 F.R.D. at 696. The court noted that a strict application of the demand requirement would lead to the dismissal of most suits brought under § 36(b). *Id.* Therefore, the court concluded that a strict interpretation of the statute would render the intentions of Congress meaningless. *Id.*

103. *See, e.g.*, *Markowitz v. Brody*, 90 F.R.D. 542, 546 (S.D.N.Y. 1981); *Untermeyer v. Fidelity Daily Income Trust*, 79 F.R.D. 36, 44 (D. Mass. 1978). In *Markowitz*, the court concluded that the *Boyko* decision's primary concern was that non-interested directors would be able to terminate the suit if demand were required. 90 F.R.D. at 558-59. The *Markowitz* court then determined that the concern voiced in *Boyko* was no longer valid in light of the Supreme Court's decision in *Burks* which seemed to preclude director termination of § 36(b) suits. *Id.* For further discussion of *Burks*, see note 81 *supra*.

The *Untermeyer* court similarly refused to follow the *Boyko* reasoning and held that there would be no presumption of futility even where it is alleged that 50% of a fund's board of directors is "affiliated" with the investment adviser. 79 F.R.D. at 44. One commentator has severely questioned the *Boyko* decision, finding its reasoning "suspect." Comment, *The Demand and Standing Requirements in Stockholder Derivative Actions*, 44 U. CH. L. REV. 168, 177 (1979). Another commentator has, however, agreed with the *Boyko* holding because it lessens the overly burdensome obstacle of the demand requirement. *See Note, Derivative Suits: Director Demand Under Rule 23.1 and Section 36(b) of the Investment Company Act*, 4 FORDHAM URBAN L.J. 565, 579 (1976).

104. For a discussion of these three issues, see notes 36-103 and accompanying text *supra*.

105. For a discussion of the implied right of action under § 36(b), see notes 50-76 and accompanying text *supra*. A finding by the Court that a mutual fund does have an implied right of action under § 36(b) would cause the demand requirement of Rule 23.1 to be applicable making it necessary for the Court to resolve the other issues raised by the interaction of § 36(b) and the demand requirement. These issues

Court decisions on implied rights of action compel a finding that the mutual fund itself *does not* have the right to assert an action under section 36(b).¹⁰⁶ If the mutual fund itself did not have an implied private right of action, a suit by a shareholder would not constitute an attempt to “enforce a right which may properly be asserted” by the corporation and Rule 23.1 would therefore be inapplicable.¹⁰⁷

This is the result which was reached by the Second Circuit in *Fox*¹⁰⁸ and by Judge Gibbons of the Third Circuit in his dissent in *Weiss*.¹⁰⁹ After determining that section 36(b) does not expressly confer a right of action on the mutual fund, the *Fox* panel and Judge Gibbons examined both the statutory scheme of the ICA and its legislative history in search of affirmative evidence that Congress intended the mutual fund to have an implied right of action.¹¹⁰ It is suggested that this two-step analysis reflects the approach mandated by the Supreme Court in *Touche Ross* and *Transamerica*.¹¹¹ Having found nothing to indicate such congressional intent, the Second Circuit and Judge Gibbons correctly concluded that section 36(b) does not give rise to an implied right of action.¹¹² This interpretation of the legislative history of section 36(b), correctly indicates that the congressional purpose in amending the ICA to include section 36(b) was simply to increase the availability of suits by shareholders challenging excessive adviser fees.¹¹³

It is suggested that the decisions of the First Circuit in *Grossman* and Third Circuit in *Weiss*, both of which found an implied right of action under section 36(b),¹¹⁴ are inconsistent with the Supreme Court’s holdings in *Touche Ross*, *Transamerica* and the cases which have followed.¹¹⁵ In *Grossman*, the First Circuit failed to discuss any of the relevant Supreme Court cases in

would include whether Congress intended the demand requirement to apply to § 36(b) and whether demand should be presumed futile due to the structure of the mutual fund and the inherent conflict of interest existing between the fund and its investment adviser. See notes 77-103 & 22-25 and accompanying text *supra*.

106. For a discussion of *Cort*, *Touche Ross*, and *Transamerica*, see notes 39-46 and accompanying text *supra*.

107. For the text of Rule 23.1, see note 5 *supra*.

108. For a discussion of the Second Circuit’s opinion in *Fox*, see notes 66-76 and accompanying text *supra*.

109. For a discussion of Judge Gibbons’ dissent in *Weiss*, see notes 62-65 and accompanying text *supra*.

110. For a discussion of *Fox* and Judge Gibbons’ dissent in *Weiss*, see notes 62, 63 & 76 and accompanying text *supra*.

111. For a discussion of the approach mandated in *Touche Ross* and *Transamerica*, see note 46 and accompanying text *supra*.

112. For a discussion of the reasoning of the Second Circuit and Judge Gibbons, see notes 63 & 76 and accompanying text *supra*.

113. For a discussion of the Congressional purpose in amending the ICA, see notes 28-32 & 75 and accompanying text *supra*.

114. For a discussion of *Grossman* and *Weiss*, see notes 51-61 and accompanying text *supra*.

115. For a discussion of these cases, see notes 44-49 and accompanying text *supra*.

finding an implied right of action.¹¹⁶ Further, in critiquing the Third Circuit's opinion in *Weiss*, it appears that the court applied the four-factor *Cort* test without considering Supreme Court decisions subsequent to *Cort*, in which the availability of implied rights of action under a federal statute had been further limited.¹¹⁷

While both of these courts found the legislative history of section 36(b) silent on the question of congressional intent,¹¹⁸ it is suggested that both courts failed to recognize that, under *Transamerica*, such silence creates a "strong presumption" against a finding that Congress intended to imply a cause of action under the statute.¹¹⁹ Neither the *Weiss* nor the *Grossman* courts were able to rebut this presumption. Therefore, their creation of an implied right of action without an affirmative showing that Congress intended such a result was improper. As further support for this argument, it is suggested that the *Sea Clammers* decision requires that a stronger showing of Congressional intent be made where the statute in question provides both an express remedy and a mechanism for its enforcement.¹²⁰ Section 36(b) expressly provides for a specific remedy which can be enforced only by the Securities Exchange Commission or a mutual fund shareholder.¹²¹ Therefore, an even stronger showing that Congress intended that the mutual fund have a cause of action was necessary before such an action could be implied, a showing the *Weiss* and *Grossman* courts could not make.¹²²

V. CONCLUSION

Section 36(b) of the ICA affords necessary protection to mutual fund shareholders.¹²³ Requiring that demand be made on the directors of a mutual fund before an action is brought under section 36(b) unnecessarily limits this protection by placing an unreasonable burden on mutual fund shareholders.¹²⁴ This is arguably a burden which Congress never contemplated,¹²⁵ and one that can not be justified in light of the rationales

116. For a discussion of *Grossman* see notes 51-55 and accompanying text *supra*.

117. For a discussion of *Weiss* see notes 57-61 and accompanying text *supra*.

118. See note 59 *supra*.

119. 444 U.S. at 18. See note 46 *supra*.

120. For a discussion of *Sea Clammers*, see notes 47-49 and accompanying text *supra*.

121. See Investment Company Act of 1940, § 36(b), 15 U.S.C. § 80a-35(b) (1982).

122. For a discussion of *Weiss* and *Grossman*, see notes 51-61 and accompanying text *supra*.

123. For a discussion of why § 36(b) was necessary to protect shareholders, see notes 26-32 and accompanying text *supra*.

124. The demand requirement leads to unnecessary delay and can possibly limit shareholder recovery in a § 36(b) suit. See notes 93 & 94 and accompanying text *supra*.

125. Furthermore, if Congress did not intend the mutual fund to have an implied cause of action under § 36(b), they would have known that no demand would be required. See notes 34 & 35 and accompanying text *supra*. For a discussion of the arguments supporting the proposition that Congress never intended the demand re-

normally given for the imposition of a demand requirement.¹²⁶

In reviewing the *Fox* decision, the Supreme Court should affirm the Second Circuit's opinion and deny the mutual fund an implied right of action under section 36(b). It is suggested that for the Court to do otherwise would be to undercut their previous mandate that a private right of action should be implied under a federal statute only when it can be shown that Congress intended such a result.¹²⁷

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quirement be applied in a § 36(b) action, see notes 77-96 and accompanying text *supra*.

126. For a discussion of these rationales see note 83 *supra*.

127. One reason given to explain the Court's desire to limit implied causes of action is to decrease the case load burdens of the Federal court system. Justice Stevens, dissenting in *Middlesex*, stated that "[i]n recent years . . . a Court that is properly concerned about the burdens imposed upon the Federal Judiciary, the quality of the work product of Congress, and the sheer bulk of new federal legislation, has been more and more reluctant to open the courthouse to the injured citizen." 453 U.S. at 24-25 (Stevens, J., dissenting). Allowing the mutual fund to assert an implied right of action under § 36(b) would make the demand requirement of Rule 23.1 of the Federal Rules of Civil Procedure applicable and would possibly allow the fund directors to pursue other remedies or give them the time necessary to settle the litigation. See text accompanying notes 34 & 84 *supra*. Implying a cause of action under § 36(b) would make it incumbent on shareholders to assert a demand upon the corporation prior to instituting suit. Thus, the implication of a right of action, contrary to the usual effect of implication, would reduce, not increase the case load of the federal courts.