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## THE PAST AND FUTURE OF IMPLIED CAUSES OF ACTION UNDER THE INVESTMENT COMPANY ACT OF 1940

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In 1940, Congress enacted the Investment Company Act, a largely regulatory statute governing a growing industry of certain “investment companies,” better known as mutual funds.<sup>2</sup> Unlike other SEC-administered statutes, the Act provided no express private cause of action, but the federal courts soon began allowing suits under the Act by private investors, finding that such rights of action were “implied” in the Act. This pattern went largely unchecked -- and relatively unchallenged -- until recent years; the recognition of implied private rights of action even survived Congress’ addition of an express right of action under Section 36(b) of the Act in 1970. Recent years have witnessed a slightly more energetic debate over the issue, however, guided by a trend in the United States Supreme Court against judicial liberalist tendencies, including the inference and expansion of private rights under federal statutes. The Court’s 1995 decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*,<sup>3</sup> directly criticizing the analytical methods most of the lower courts have used to infer actions under the Act, sharpened the debate.

The Second Circuit Court of Appeals has now pushed the debate over private suits under the Act to the forefront of the judicial landscape. In March 2002, in *Olmsted v. Pruco Life Insurance Company*,<sup>4</sup> the Second Circuit -- historically a venerable champion of the private right of action under the Act -- held that no private cause of action could be inferred for violations of Sections 26(f) and 27(i) of the Act. Although these sections were enacted within the last decade, the court’s analysis -- a “back to the basics” adherence to the statutory text -- would logically apply to other, older sections of the Act, including those under which the Second Circuit has upheld private rights of action in the past. The court took specific steps, however, to leave its earlier decisions intact. As if this recent shift would not alone provoke sufficient debate, in February 2000, shortly before deciding *Olmsted*, the Second Circuit handed down a decision, *Strougo v. Bassini*,<sup>5</sup> in which it allowed a private class action to proceed under Sections 36(a) and 48 of the Act, despite its explicit recognition that Congress had not provided for private suits.

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<sup>2</sup> 15 U.S.C. §§ 80a-1 *et seq.* The Investment Company Act is often referred to as the “1940 Act,” even though Congress enacted the Investment Advisers Act that same year.

<sup>3</sup> 511 U.S. 164 (1994) (5-4 decision).

<sup>4</sup> 283 F.3d 429 (2d Cir. 2002).

<sup>5</sup> 282 F. 3d 162 (2d Cir. 2002).

The Second Circuit's decisions set the stage for this issue to come before the Supreme Court. In anticipation of the Court's ultimate disposition, this article attempts to provide an historical analysis of the recognition of implied causes of action under the Act. Part I addresses the Act itself and implied causes of action under the Act before *Central Bank*. Part II is an analysis of the relevant portions of the *Central Bank* decision, and Part III reviews the impact of *Central Bank*. Part IV is an in-depth view of the recent sharpening of the debate in the Second Circuit.

## I. THE DEVELOPMENT OF IMPLIED CAUSES OF ACTION UNDER THE 1940 ACT

### A. THE ORIGINAL 1940 ACT AND THE RECOGNITION OF IMPLIED CAUSES OF ACTION

The 1940 Act arose out of a sweeping reform of corporate and securities law provoked by the economic and political events of the 1920s and the 1930s. Between 1933 and 1940, Congress enacted six of the seven statutes currently administered by the Securities and Exchange Commission: the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, the Investment Company Act of 1940, and the Investment Advisers Act of 1940.<sup>6</sup> Unlike the 1933 and 1934 Acts, which Congress designed mainly to foster disclosure,<sup>7</sup> Congress designed the 1940 Act to regulate thoroughly an industry in apparent need of supervision.<sup>8</sup>

The "investment companies" governed by the Act included issuers of securities that engage primarily in the investment in other securities, such as mutual funds.<sup>9</sup> By their nature, these institutions, the managers of which have vast quantities of liquid and transferable assets at their disposal, present ample opportunity for mismanagement and abuse.<sup>10</sup> The Act imposed certain safeguards in the industry, such as the requirement of a minimum proportion of disinterested directors on the board of a registered investment company,<sup>11</sup> and the requirement that a majority of these directors approve contracts for adviser services.<sup>12</sup> Unlike each of the

<sup>6</sup> See 1 Louis Loss & Joel Seligman, SECURITIES REGULATION 166-223, 224 (3d ed. 1989).

<sup>7</sup> The 1933 and 1934 Acts "embrace[d] a fundamental purpose . . . to substitute a philosophy of full disclosure for the philosophy of *caveat emptor*." *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972) (internal quotation marks omitted).

<sup>8</sup> 1 Loss & Seligman, *supra* note 6, at 242; 15 U.S.C. § 78b (1997); 15 U.S.C. § 79a (1997); 15 U.S.C. § 80a-1(a)(5) (1997); 15 U.S.C. § 80a-1(b) (1997).

<sup>9</sup> 15 U.S.C. § 80a-3(a)(1) (1997).

<sup>10</sup> 1 Loss & Seligman, *supra* note 6, at 242, 247. At Congress's command, the SEC conducted a four-year investigation of the industry. Congress expressly crafted the 1940 Act from the findings of this investigation and, through the 1940 Act, announced its policy to curb abuse through registration requirements and regulation. 15 U.S.C. § 80a-1 (1997).

<sup>11</sup> 15 U.S.C. § 80a-10(a) (1997).

<sup>12</sup> 15 U.S.C. § 80a-15(c) (1997).

securities acts preceding it (the 1933 Act, the 1934 Act, the Public Utility Holding Company Act, and the Trust Indenture Act),<sup>13</sup> the original 1940 Act did not contain any express provision for private civil actions. The Act contained remedial measures, such as authorizations of the SEC to bring actions for violations of certain of its provisions, but not the private causes of action such as those found, for instance, in section 12 of the 1933 Act and section 16(b) of the 1934 Act.

Seemingly contemporaneously with the growth of mutual funds in the 1950s and 1960's,<sup>14</sup> however, the federal courts began recognizing implied rights of action to remedy violations of certain provisions of the Act.<sup>15</sup> The courts' effective recognition often resulted from mere assumption or concession, rather than actual adjudication.<sup>16</sup> The courts did affirmatively decide the issue, but often upon unsatisfactory analysis. For example, in 1963, in *Taussig v. Wellington Fund, Inc.*,<sup>17</sup> the Third Circuit held that stockholder-plaintiffs could pursue a private remedy on behalf of a fund under section 35(d) of the Act, which proscribes the use by funds of titles or names determined to be misleading by the SEC.<sup>18</sup> The court's analysis, however, was almost admittedly lacking.<sup>19</sup> Ultimately, the court recognized the competing

<sup>13</sup> See, e.g., 15 U.S.C. § 77(k)(a) (1997); 15 U.S.C. 78i(e) (1997); 15 U.S.C. § 79p (1997); 15 U.S.C. § 77www (1997)

<sup>14</sup> James N. Benedict, Mary K. Dulka, & C. Neil Gray, *Recent Developments in Litigation under the Investment Company Act of 1940*, 1250 PLI/CORP. 643, 649 (2001).

<sup>15</sup> "During the period 1959-62 some two dozen of the largest open-end investment companies, together with their directors and 18 investment advisers, were involved in over 50 lawsuits centering largely, but not entirely, around allegations of grossly excessive management or advisory fees." IX Louis Loss & Joel Seligman, *SECURITIES REGULATION* 4449 n.597 (3d ed. 1989).

<sup>16</sup> For example, in *Brown v. Bullock*, 294 F.2d 415 (2d Cir. 1961), the majority of a Second Circuit panel affirmed a district court's ruling that the allegations of mutual fund shareholders sufficiently stated violations of §§ 15(a) and (b) (contracts of advisers and underwriters) and § 37 (larceny and embezzlement) of the Act. 294 F.2d at 420-21. A concurring opinion, however, noted that, regrettably, the more important threshold issue of the existence of an implied private cause of action for these alleged violations had been conceded by the defendants. *Id.* at 422 (Clark, J., concurring). In *Levitt v. Johnson*, 334 F.2d 815 (1st Cir. 1964), the First Circuit decided that strict application of state law demand requirements to a derivative suit brought under the Act would conflict with the goals of the Act. *Id.* at 819. The court assumed, however, without comment, and without even noting the particular section of the Act at issue, that the Act gave rise to such an implied right of action in the first place. *Id.*

<sup>17</sup> 313 F.2d 472 (3d Cir. 1963).

<sup>18</sup> 15 U.S.C. § 80a-34(d) (1997).

<sup>19</sup> First, as was astutely pointed out in a dissenting opinion, § 35(d) prohibits only the use of names found misleading by the SEC, suggesting that civil enforcement should occur exclusively through, or should at least be preceded by, an SEC determination. *Taussig*, 313 F.2d at 482 (Smith, J., dissenting). The court cited the jurisdictional section of the Act, which bestows on the federal courts jurisdiction of "all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of the Act," 15 U.S.C. § 80a-43 (1997), as its only legislative authority for its decision, noting that while the Act did not expressly grant any private cause of action, this section "seems to provide a forum for such

positions on the issue of whether a private right can be derived from the Act, and it simply chose the position that a right could be so inferred, for no other apparent reasons than that this position was “not frivolous,” that it was not expressly proscribed by Supreme Court law, and that other courts had adopted it in interpreting the 1934 Act.<sup>20</sup>

### B. THE 1970 AMENDMENTS

In a key event in the history of implied causes of action under the Act,<sup>21</sup> in 1970 Congress amended the 1940 Act to add section 36(b): an express right of action for the violation of fiduciary duties. A Senate Committee found that “mutual funds, with rare exception,” are operated not by their own employees, but by separate organizations known as “investment advisers.”<sup>22</sup> “The[se] advisers select the funds’ investments and operate their businesses” and in return are paid fees, often calculated as a percentage of the funds’ net assets.<sup>23</sup> The committee found that this unique structure is different than the normal relationship between buyers and sellers of services, as the funds’ dependence on the advisers practically prevented the funds from

suits.” *Taussig*, 313 F.2d at 476. The court did not note that this jurisdictional statement is substantially similar to the counterpart provisions in other SEC statutes that do expressly provide for private causes of action, such as § 78aa of the 1934 Exchange Act.

<sup>20</sup> *Id.* Each of these three reasons, however, would apply equally to support a decision that no implied right of action existed. In 1961, in *Brouk v. Managed Funds, Inc.*, 286 F.2d 901 (8th Cir. 1961), *vacated as moot by agreement*, 369 U.S. 424 (1962), the Eighth Circuit, noting that it would find an implied right of action only to “implement a manifest legislative intent,” *id.* at 912, held that the 1940 Act did not by implication create a private cause of action against directors of funds. *Id.* A few years later, however, the court called its own decision into question in *Greater Iowa Corp. v. McLendon*, 378 F.2d 783 (8<sup>th</sup> Cir. 1967). There, the court stated that, in light of the Supreme Court’s holding in *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964), that § 14(a) of the 1934 Act implicitly gave rise to private civil remedies, and its directive to the federal courts “to adjust their remedies so as to grant the necessary relief where federally secured rights are invaded,” *Borak*, 377 U.S. at 433, it should “reexamine” its holding in *Brouk*. *McLendon*, 378 F.2d at 793. In *Esplin v. Hirschi*, 402 F.2d 94 (10th Cir. 1968), the court found that “although the Investment Company Act makes no specific provision for private civil liability arising from the violations of the Act,” private rights of action “may be implied.” 402 F.2d at 103. The court’s only analysis, however, was its brief notation of an apparent “strong indication” to find private civil liability under federal statutes announced in *Borak*. *Id.*

<sup>21</sup> Mutual funds had grown during the 1950’s and 1960’s. As a result, investment advisers to the funds, which often earned a fee based on a fixed percentage of the particular fund’s assets, had begun to earn increasingly large fees. SEC, *Public Policy Implications of Investment Company Growth*, H.R. Rep. No. 2337, 89th Cong., 2d Sess. (1966); *see generally* Benedict, *et al.*, *Recent Developments*, *supra* note 14, at 648. In a 1966 report to Congress, the SEC noted that, among other problems in the industry, these fixed-percentage fees failed to recognize the economies of scale present in managing large funds. SEC, *Public Policy Implications of Investment Company Growth*, H.R. Rep. No. 2337, 89th Cong., 2d Sess. (1966); *see generally* Benedict, *et al.*, *Recent Developments*, *supra* note 14, at 648.

<sup>22</sup> S. Rep. 91-184.

<sup>23</sup> *Id.*

severing the relationship. Thus, found the committee, “the forces of arm’s-length bargaining” present “in other sectors of the American economy” are not present in the mutual fund industry.<sup>24</sup> To address this concern, Congress added section 36(b), which imposed a fiduciary duty on the investment advisers of registered funds “with respect to the receipt of compensation for services,” *and* which expressly provided a cause of action, not only to the SEC but to shareholders of registered funds, for breach of this duty.<sup>25</sup> Thus, the Act, which once did not expressly provide for a private cause of action to enforce *any* of its provisions, now expressly authorized private citizens to enforce one, *but only one*, of its provisions. On the other hand, Congress, while making substantial amendments to the Act, had not expressly overruled the implied rights of action recognized by the courts since the Act’s inception. In fact, the Senate Report expressly cautioned that the fact that subsection (b) specifically provides for a private right of action “should not be read by implication to affect subsection (a).”<sup>26</sup>

While the addition of section 36(b) suggested to some that implied rights of action should no longer be recognized, the effect of the 1970 Amendments on the recognition of implied causes of action by the federal courts, if anything, was liberalizing.<sup>27</sup> The courts not only rejected the argument that the amendment adding section 36(b) indicated Congressional intent that courts not allow private suits under any other provisions, but they embraced the 1970 Amendments, which left the federal courts’ pattern of recognizing implied rights of action intact, as further evidence that Congress approved of such recognition. For example, in *Tannenbaum v.*

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<sup>24</sup> *Id.*

<sup>25</sup> 15 U.S.C. § 80a-35(b) (1997). Bolstering subsequent arguments that Congress “knew how” to create a cause of action when it “wanted to,” Congress set forth the parameters of the cause of action. The plaintiff would bear the burden of proving a breach of fiduciary duty. 15 U.S.C. § 80a-35(b)(1). Damages would be limited to the actual damage suffered through the breach and could not exceed the total compensation received by the defendant. 15 U.S.C. § 80a-35(b)(3). Damages would also be limited to those incurred within one year of the institution of the action. 15 U.S.C. § 80a-35(b)(3). Jurisdiction would lie exclusively with the federal district courts of the United States. 15 U.S.C. § 80a-35(b)(5).

<sup>26</sup> S. Rep. 91-184; *see also* H. Rep. No. 91-1382, 91st Cong. 2d Sess. 38 (1970).

<sup>27</sup> Just after the 1970 Amendments, in 1971, the First Circuit decided *Moses v. Burgin*, 445 F.2d 369 (1971), a case involving allegations of an investment adviser’s failure to recapture brokerage commissions paid by its mutual fund client. The court confirmed its authority to grant civil recovery for acts falling within the proscription of “gross misconduct or gross abuse of trust” contained in the pre-amendment § 36, glossing over in a footnote the fact that the recent amendments had removed this language. 445 F.2d at 373 & n.7. The amendment substituted the phrase, “breach of fiduciary duty involving personal misconduct” for the removed language. The House Committee Report set forth an explanation of this language: “In appropriate cases, non-feasance of duty or abdication of responsibility would constitute a breach of fiduciary duty involving personal misconduct.” *See* Report of the Committee on Interstate and Foreign Commerce, H. Rep. No. 1382, 91st Cong., 2d Sess. 37 (1970). In 1975, in *Fogel v. Chestnutt*, 533 F.2d 731 (2d Cir. 1975) (“*Fogel I*”), the Second Circuit followed *Moses* and assumed the existence of private liability for breach of fiduciary duty with respect to the recapture of brokerage fees; the parties did not contest the issue. *See Fogel v. Chestnutt*, 668 F.2d 100, 105 (2d Cir. 1981).

*Zeller*,<sup>28</sup> a case involving allegations of an investment adviser's failure to recapture brokerage commissions paid by its mutual fund client, the Second Circuit noted that the original form of section 36 expressly authorized SEC injunction actions and implicitly authorized private actions. The court rejected the argument that Congress' addition of an explicit right of action with respect to compensation was intended to abrogate the private actions already recognized by the courts for other types of breach of fiduciary duty.<sup>29</sup>

In 1981, in *Fogel v. Chestnutt* ("*Fogel II*"),<sup>30</sup> the appellants argued that Supreme Court authority decided after *Fogel I* rendered the court's and the parties' assumption of the availability of private recovery in *Fogel I* incorrect.<sup>31</sup> The appellants argued that *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11 (1979), in which the Supreme Court held that the Investment Advisers Act of 1940 did not imply a private cause of action for damages, changed the landscape.<sup>32</sup> The court rejected this argument, noting that *Transamerica* did allow a private suit in equity under the Advisers Act, and the jurisdictional grant in the Advisers Act, originally drafted as identical to that in the Investment Company Act, was changed prior to enactment to provide jurisdiction for only "suits in equity" and not "actions at law."<sup>33</sup> The court again rejected the notion that the addition of the cause of action in section 36(b) abrogated the existing implied causes of action, noting that, rather, the fact that the Investment Company Act had been overhauled after these rights of action had been recognized suggests Congressional approval.<sup>34</sup>

<sup>28</sup> 552 F.2d 402 (2d Cir. 1977).

<sup>29</sup> 552 F.2d at 416-17.

<sup>30</sup> 668 F.2d 100 (2d Cir. 1981).

<sup>31</sup> 668 F.2d at 105.

<sup>32</sup> *Id.* at 109. The appellants also cited *Cort v. Ash*, 422 U.S. 66 (1975). In *Cort*, the Supreme Court transformed the test for the availability of private rights of action from the simple question of whether the plaintiff was a member of a special class for whose benefit the statute was enacted, to a more rigid, four-factor analysis of the actual words and intent of Congress. *See Cort*, 422 U.S. at 78 (noting the following factors: 1) whether the plaintiff is a member of the class for whose benefit the statute was enacted; 2) whether there is any explicit or implicit indication of Congressional intent to create or withhold private remedies; 3) whether the availability of private recovery would be consistent with the purposes of the statute; and 4) whether the contemplated private cause of action is one conventionally relegated to state law). In later years, the Court further refined the *Cort* test, stating that legislative intent is the most important factor, while the others are supplementary. *See, e.g., Touche Ross & Co. v. Redington*, 442 U.S. 560, 575-76 (1979) (holding that not all the *Cort* factors should be weighted equally and that the main inquiry is congressional intent). The *Fogel II* court noted that the appellants had cited *Cort v. Ash* and *Touche Ross*, but it commented only on *Transamerica*. *Id.* at 109-12.

<sup>33</sup> *Fogel II*, 668 F. 2d at 109.

<sup>34</sup> *Id.* at 111-12. In 1990, as part of the Securities Law Enforcement Remedies Act of 1990, Congress added the "actions at law" language to the jurisdictional grant in the Advisers Act, the absence of which proved so important to the *Transamerica* Court. The legislative history surrounding the 1990 amendment

### C. THE 1980 HOUSE REPORT

A House Committee Report that accompanied additional amendments to the Act in 1980, through the Small Business Investment Incentive Act of 1980, provided additional, retrospective support for the courts that had decided that finding implied rights of action under the Act should continue after the 1970 Amendments.

The rationale for implying rights of action under the securities laws beyond those actions expressly provided for had been well articulated by the Supreme Court when it observed that implied private rights of actions allowing shareholders to sue to remedy their losses would significantly assist the congressional goal of promoting fair corporate suffrage. But in recent years, the Supreme Court turned its focus toward a strict construction of statutory language and expressed intent.

The Committee wishes to make plain that it expects the courts to imply private rights of action under this legislation, where the plaintiff falls within the class of person protected by the statutory provision in question. Such a right would be consistent with and further Congress' intent in enacting that provision, and where such actions would not improperly occupy an area traditionally the concern of state law. In appropriate instances, for example, breaches of fiduciary duty involving personal misconduct should be remedied under Section 36(a) of the Investment Company Act. With respect to the business development companies, the Committee contemplates suits by shareholders as well as by the Commission, since these are the persons the provision is designed to protect, and such private rights of action will assist in carrying out the remedial purposes of Section 36.<sup>35</sup>

In *Bancroft Convertible Fund v. Zico Investment Holdings, Inc.*,<sup>36</sup> the Third Circuit opined that “[c]learly, the Committee Report expressly approves the position of those courts which, following the 1970 amendments, held that private causes of action should be implied from the Investment Company Act.”<sup>37</sup> The court held that a private right of action existed under

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does not suggest that the addition of this language represents congressional intent to create a private right of action for damages under the Advisers Act.

<sup>35</sup> H.R. Rep. No. 1341, 96th Cong., 2d Sess., 28-29 (1980). The 1980 enactment added a number of new provisions to the Act, giving special treatment to certain business development companies and, in effect, amending existing provisions of the Act. Thus, the statements in the House Committee Report were only partially retrospective.

<sup>36</sup> 825 F.2d 731 (3d Cir. 1987).

<sup>37</sup> 825 F.2d at 736.



section 12(d)(1)(A) of the Act, which prohibits the acquisition by an investment company of more than three percent of the outstanding stock of another investment company.<sup>38</sup>

## II. CENTRAL BANK

In 1994, however, the Supreme Court cast considerable doubt on the statutory interpretive principles that supported the decisions of those courts that had recognized private rights of action under the Act. *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*,<sup>39</sup> was not about the Investment Company Act, but rather the scope of the implied private right of action under section 10(b) of the 1934 Act.<sup>40</sup> The Court had granted *certiorari* to resolve confusion among the lower courts about the viability of private liability for section 10(b) aiding and abetting in light of the Court's recent strict interpretations of the securities laws in *Santa Fe Industries, Inc. v. Green*<sup>41</sup> and *Ernst & Ernst v. Hochfelder*.<sup>42</sup> The Court noted that, in defining the scope of a statutory prohibition, it must adhere strictly to the statutory text, and it would not allow a private section 10(b) suit for conduct not prohibited by the text of the statute.<sup>43</sup> Noting that the text also did not mention aiding and abetting, the Court rejected the SEC's argument that the phrase "directly or indirectly" in the text of the statute indicated coverage of aiding and

<sup>38</sup> *Id.* at 733, 736. Other courts held similarly. *See, e.g., In re ML-LEE Acquisition Fund II, L.P. & ML-LEE Acquisition Fund (Retirement Accounts) II, L.P. Sec. Litig.*, 848 F. Supp. 527, 538-49 (D. Del. 1994) (finding implied rights of action under §§ 17(j), 36(a), and 57(a), (d)); *Lessler v. Little*, 857 F.2d 866, 873 (1st Cir. 1988) (recognizing private cause of action under section 17(a)(2) of the Investment Company Act); *Fogel v. Chestnutt*, 668 F.2d 100, 111 (2d Cir. 1981) (recognizing implied rights of action for damages under section 36(a) of Investment Company Act where advisers or directors breach fiduciary duty); *Meyer v. Oppenheimer Management Corp.* 764 F.2d 76, 86-88 (2d Cir. 1985) (recognizing implied private right of action under section 15(f) of Investment Company Act); *Krome v. Merrill Lynch & Co.*, 637 F. Supp. 910 (recognizing implied private rights of action under sections 10(b), 15(a-b), 17(a), 22, 34(a), and 36 of the Investment Company Act), *vacated in part*, 110 F.R.D. 693 (S.D.N.Y. 1986); *Jerozal v. Cash Reserve Management, Inc.*, No. 81 Civ. 1569, 1982 WL 1363, at \*4-5 (S.D.N.Y. August 10, 1982) (recognizing implied private rights of action under sections 15, 35(b), 47(a) of the Investment Company Act); *Cambridge Fund, Inc. v. Abella*, 501 F. Supp. 598, 622-23 (S.D.N.Y. 1980) (implying private right of action under 36(a) and 37 of the Investment Company Act). *But see Potomac Capital Markets Corp. v. Prudential-Bache Corp. Dividend Fund, Inc.*, 726 F. Supp. 87, 92-94 (S.D.N.Y. 1999) (denying rights of action under §§ 13(a)(4), 25(a), although recognizing private right to enforce § 13(a)(3); *M.J. Whitman & Co. v. American Fin. Enter., Inc.*, 552 F. Supp. 17, 22 (S.D. Ohio 1982) (holding that no general private right of action existed against company's failing to register under the Act), *aff'd*, 725 F.2d 394 (6th Cir. 1984).

<sup>39</sup> 511 U.S. 164 (1994) (5-4 decision).

<sup>40</sup> *Id.* at 165-67.

<sup>41</sup> 430 U.S. 462 (1977). *See id.* at 473 (holding that § 10(b) does not prohibit breaches of fiduciary duty without misrepresentation or lack of disclosure).

<sup>42</sup> 425 U.S. 185 (1976). *See id.* at 199 (holding that § 10(b) does not reach negligent conduct).

<sup>43</sup> *Central Bank*, 511 U.S. at 173.

abetting,<sup>44</sup> as “Congress knew how to impose aiding and abetting liability when it chose to do so.”<sup>45</sup>

The *Central Bank* Court went on, however, in *dicta*, assuming *arguendo* that it needed to look beyond the text of the statute to determine its scope, to opine on “how the 1934 Congress would have addressed the issue had the 10b-5 action been included as an express provision in the 1934 Act.”<sup>46</sup> In so doing, the Court addressed arguments concerning congressional intent. The Court rejected the argument that references to aiding and abetting liability under section 10(b) in 1983 and 1988 Committee Reports demonstrated congressional intent that 10(b) prohibits aiding and abetting: “We have observed on more than one occasion that the interpretation given by one Congress (or a committee or member thereof) to an earlier statute is of little assistance in discerning the meaning of that statute.”<sup>47</sup> The Court also cast doubt on the strength of the “acquiescence” doctrine as an indicator of congressional intent, noting that the mere fact that Congress had amended the 1934 Act after the courts first began recognizing a private section 10(b) remedy for aiding and abetting did not represent affirmative congressional approval of the statutory precedents.<sup>48</sup> Similarly, in addressing an argument about rejected additions to the 1934 Act that would have expressly outlawed aiding or abetting a violation of the Act, the Court noted that “failed legislative proposals” are shaky ground on which to rest statutory interpretation.<sup>49</sup>

Thus, the Court, either wittingly or unwittingly, clearly rejected the interpretive principles upholding decisions such as *Tannenbaum*, *Fogel II*, and *Bancroft*. As was noted by the *Central Bank* Court, however, its task -- to determine the scope of the prohibitions of a statute -- was more limited than that before those courts -- to determine whether to recognize an implied right of action at all.<sup>50</sup> The Court expressly distinguished the two questions: “With [respect] to the first issue, the scope of conduct prohibited by section 10(b), [as opposed to the question of the existence of a private right of action under section 10(b)], the text of the statute controls our decision.”<sup>51</sup> The Court did not explain why congressional silence would control the question of the scope of the prohibitions of a statute, but not the question of who may enforce those prohibitions, but, nonetheless, it carefully drew that distinction before rendering its opinion.

<sup>44</sup> *Id.* at 175-76.

<sup>45</sup> *Id.* at 176.

<sup>46</sup> *Id.* at 178 (quoting *Musick, Peeler & Garret v. Employers Ins.*, 508 U.S. 286, 294 (1993)).

<sup>47</sup> *Public Employees Retirement Sys. v. Betts*, 492 U.S. 158, 168 (1989) (quoted in *Central Bank*, 511 U.S. at 185-86).

<sup>48</sup> *Central Bank*, 511 U.S. at 186.

<sup>49</sup> *Id.* at 187.

<sup>50</sup> See *id.* at 172-73 (noting the distinction between determining the scope of conduct prohibited by § 10(b) and deciding elements of an implied private liability scheme).

<sup>51</sup> *Id.* at 173.

Thus, the rationale of the *Central Bank* holding does not ultimately control the question of implied rights of action under the 1940 Act. Some commentators have overreacted to the *Central Bank* decision and opined that it does, but that is inaccurate.<sup>52</sup> In particular, the *Central Bank* Court's comment, "Congress knew how to impose aiding and abetting liability when it chose to do so,"<sup>53</sup> has been taken out of context to suggest that Congress also knew how to create a private right of action when it chose to do so. Because the *Central Bank* Court was determining the scope of implied rights of action under section 10(b), however, implicit in its holding was the recognition that Congress may not always "know how" to create a right of action when it "wants to," and often leaves that task to the courts.

### III. IMPLIED RIGHTS OF ACTION UNDER THE 1940 ACT AFTER *CENTRAL BANK*

*Central Bank* did not deter federal courts from interpreting the Act to provide private remedies. In *Krouner v. American Heritage Fund, Inc.*,<sup>54</sup> the court dismissed claims brought under section 8(b)(3) and (5) of the Act, which governs the required disclosures in a registration statement, and under section 13(a)(3), which governs deviation from investment policies.<sup>55</sup> This was only because the complaint failed to state a violation of either section, however, and not because of any doubt over the existence of a private cause of action for such a violation. In fact, the court did not differentiate between these claims and the plaintiff's claim under section 36(b). In *Langner v. Brown*,<sup>56</sup> another court of the Southern District of New York addressed the issue, but it relied directly on interpretive tools rejected by *Central Bank*. The court did not cite *Central Bank* and, constrained by the holding of *Fogel II* (the rationale of which was called into question by, but which was technically left intact by, *Central Bank*), held that the only question was whether the plaintiffs fell within the class of persons the particular section of the Act was designed to protect.<sup>57</sup> In 1996, in *Blatt v. Merrill Lynch, Pierce, Fenner & Smith Inc.*,<sup>58</sup> the court cited *Central Bank*, but only for the proposition that its analysis must begin with the text of the statute.<sup>59</sup> The court went on to hold that sections 47 and 44, which provide, respectively, that

<sup>52</sup> Some commentators have reported, inaccurately, that "Central Bank plainly instructs that absent express statutory language providing citizens a private right of action, federal courts should decline to imply one." See, e.g., Benedict, *et al.*, *Recent Developments*, *supra* note 14, at 665-66. To the contrary, *Central Bank* interpreted the scope of conduct reachable *through an implied right of action under § 10(b)*. The decision simply cannot be construed as "signal[ing] a strong presumption against implying rights of action under the federal securities laws." *Id.* at 665.

<sup>53</sup> *Central Bank*, 511 U.S. at 176.

<sup>54</sup> 899 F. Supp. 142 (S.D.N.Y. 1995).

<sup>55</sup> *Id.* at 148-49.

<sup>56</sup> 913 F. Supp. 260 (S.D.N.Y. 1996).

<sup>57</sup> *Id.* at 268.

<sup>58</sup> 916 F. Supp. 1343 (D.N.J. 1996).

<sup>59</sup> *Id.* at 1349.

contracts in violation of the Act are unenforceable and rescindable and that federal courts have jurisdiction over suits at law and equity under the Act, sufficiently evidenced congressional intent to provide a private remedy under sections such as section 7 of the Act.<sup>60</sup> Other district courts decided cases presenting implied rights of action under the 1940 Act without any discussion of the issue at all, let alone comment on the impact of *Central Bank*.<sup>61</sup>

The first decision to deal head on with the teachings of *Central Bank* was *In re Nuveen Fund Litigation*, in which the court recognized private causes of action under sections 34(b) and 36(a) of the 1940 Act.<sup>62</sup> First distinguishing *Transamerica*, the court stated that the subsequent legislative history of the Act and the fact that Congress had not yet commented on or prohibited implied rights of action were indicators of congressional intent to allow private remedies.<sup>63</sup> The court rejected the defendants' argument that *Central Bank* rendered this reasoning unworkable, but in doing so, it simply relied on the type of evidence of congressional intent rejected by *Central Bank*: the 1980 House Committee report expressing the expectation that courts will recognize implied rights of action.<sup>64</sup> The *Nuveen* court stated that this report carried weight despite *Central Bank*, because the subsequent congressional reports at issue in *Central Bank* contained, as the *Central Bank* Court noted, only "oblique" references to aiding and abetting liability, while the 1980 House report expressly encouraged private rights of action under the 1940 Act.<sup>65</sup> This misinterpretation of *Central Bank* appears almost forced; quite clearly, the *Central Bank* Court's criticism was that the reports represented the thoughts of *one committee* of a *subsequent* Congress, not that the language in the reports was insufficiently direct<sup>66</sup> -- a criticism that applies equally to the 1980 House report. In fact, the only indicator of congressional intent cited by *Nuveen* that may survive *Central Bank*'s criticism is the Senate Report accompanying the addition of section 36(b) in 1970, cautioning against any inference that

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<sup>60</sup> *Id.* at 1349-50.

<sup>61</sup> In *Sheppard v. TCW/DW Term Trust 2000*, 938 F. Supp. 171 (S.D.N.Y. 1996), the court avoided the issue of whether § 13(a)(3) provided for private recovery by finding that the complaint failed to state a violation of the section. See *id.* at 180 n.7 ("Having found that plaintiffs fail to allege that the Trusts deviated from their fundamental policies, the Court need not address the disputed issue of whether Section 13(a)(3) of the 1940 Act provides a private right of action."). In *In re Alliance North American Government Income Trust, Inc. Securities Litigation*, No. 95 Civ. 0330 (LMM), 1996 WL 551732 (S.D.N.Y. Sept. 27, 1996), the court decided a motion to dismiss claims under the §§ 13(a)(3), 34(b), 35(d) and 48 of the Act, without any discussion about whether private recovery under those sections was even available. *Id.* at \*3-9. Apparently, the parties did not raise the issue, and the court did not see a need to raise it *sua sponte*.

<sup>62</sup> No. 94 C 360, 1996 WL 328006 (N.D. Ill. June 11, 1996).

<sup>63</sup> *Id.*, 1996 WL 328006, at \* 5.

<sup>64</sup> *Id.* at \*5.

<sup>65</sup> *Nuveen*, 1996 WL 328006, at \*6.

<sup>66</sup> *Central Bank*, 511 U.S. at 185.

the new cause of action changed the state of the law with respect to section 36(a).<sup>67</sup> That report, however, speaks to contemporary congressional intentions only for section 36(b). It does not support the *Nuveen* court's holding that section 34(b) provides a private right of action, and it does not speak to the intentions of the 1940 Congress that enacted section 36(a).<sup>68</sup>

In *Strougo v. Scudder, Stevens & Clark, Inc.*,<sup>69</sup> a court in the Southern District of New York followed suit, citing *Nuveen* and holding that section 36(a) implied a private right of action, despite *Central Bank*. The court noted that the cameral reports that stated that the addition of section 36(b) did not affect section 36(a), but the court also went on to cite the statements in the 1980 House Committee Report, despite its own recognition that an important factor in determining an implied right of action is "the *contemporary* legal context in which Congress acted."<sup>70</sup> *Strougo* does not deserve the extent of the criticism it has received; it certainly is not guilty of ignoring any "marked aversion toward implied rights" shown in *Central Bank*,<sup>71</sup> as *Central Bank*, defining the conduct reachable through an implied right of action under section 10(b), displayed no such aversion. *Strougo*, however, like *Nuveen*, resonates with an inconsistency on the treatment of congressional silence and inaction. According to its logic, where Congress does not expressly overrule court action, it has approved it. Where Congress has enacted a private cause of action for some sections but has not for others, however, the courts acknowledge nothing implicit in this silence.<sup>72</sup>

It was not until 1997 that a court, the Seventh Circuit, signaled at least a recognition that *Central Bank* had undermined the analysis that supported earlier decisions to recognize implied rights of action under the 1940 Act. In *Boland v. Engle*,<sup>73</sup> the court stated, in a footnote, that *Central Bank* "cast doubt on the type of analysis that courts have used to find implied rights of action," but that "fortunately [we] need not enter this debate because . . . we find that . . .

<sup>67</sup> *Nuveen*, 1996 WL 328006, at \*6.

<sup>68</sup> Of course, one must consider the role of the fundamental doctrine of *stare decisis* in the analysis of the *Nuveen* and other courts. At least with respect to § 36(a), the *Nuveen* court could have relied on prior decisions recognizing causes of action and limited its search for congressional intent to any recent/subs. intent to overrule those decisions. The court went further, however, and interpreted the 1970 Congress's actions as acceptance of the entire state of judicial recognition of private recovery under the Act. See *Nuveen*, 1996 WL 328006, at \*6.

<sup>69</sup> 964 F. Supp. 783 (S.D.N.Y. 1997).

<sup>70</sup> *Id.* at 796-97, & n.3 (emphasis added).

<sup>71</sup> Benedict, *et al.*, *Recent Developments*, *supra* note 14, at 670.

<sup>72</sup> Of course, the 1970 Congress was not completely "silent" as to the effect of the addition of § 36(b) on the availability of private recovery under § 36(a).

<sup>73</sup> 113 F.3d 706 (7th Cir. 1997).

Boland's ICA claims were properly dismissed for other reasons."<sup>74</sup> Still, subsequent district court decisions assumed or recognized the presence of private rights of action under the Act.<sup>75</sup>

#### IV. OLMSTED

##### A. THE DISTRICT COURT'S OPINION

In fact, the first district court to carefully consider and then reject the notion of implied rights of action under the Act, *Olmsted v. Pruco Life Insurance Company of New Jersey*,<sup>76</sup> did not even rely heavily on *Central Bank*. The *Olmsted* court faced the question, of first impression, of whether sections 80a-26(e) (requiring reasonable fees deducted in connection with variable insurance contracts) and 80a-27(i) (requiring compliance with section 80a-26(e) in sale of variable insurance contracts) provided a private cause of action.<sup>77</sup> These sections had been added to the Act by amendments in 1996.<sup>78</sup> Although the court did not cite *Central Bank* at this point in its analysis, it seemed to be acting in reaction to its teachings, as the court answered this question by going back to the basics of statutory interpretation, and avoiding the interpretive principles rejected by in *Central Bank*. The court noted that, since 1975, determining the availability of a private cause of action involved not merely asking whether the plaintiff was a member of a class the statute was designed to protect.<sup>79</sup> Rather, the analysis followed the four-part test announced in *Cort v. Ash*, which had been subsequently tailored to focus especially on legislative intent.<sup>80</sup> Searching for legislative intent, the court held that, given the Act's broad grant of power to the SEC to investigate and bring injunction or penalty actions for violations of the Act, "it is highly improbable that 'Congress absentmindedly forgot to mention an intended private action' as a supplemental enforcement mechanism."<sup>81</sup> The court also held that the fact that Congress added the express cause of action in section 36(b) further indicated that when Congress wanted to create a right of action, "it knew how to do so."<sup>82</sup> Having decided the

<sup>74</sup> *Id.* at 715 n.9.

<sup>75</sup> See, e.g., *Green v. Fund Asset Mgmt., L.P.*, 19 F. Supp. 2d 227, 232 (D.N.J. 1998) (assuming existence of private right of action under § 36(a) of the 1940 Act); *Young v. Nationwide Life Ins. Co.*, 2 F. Supp. 2d 914, 925 (S.D. Tex. 1998) (holding that § 36(a) implies a private right of action, despite the teachings of *Central Bank*).

<sup>76</sup> 134 F. Supp. 2d 508 (E.D.N.Y. 2000).

<sup>77</sup> *Id.* at 511.

<sup>78</sup> 15 U.S.C. § 80a-26(e) (1997); 15 U.S.C. § 80a-27(i) (1997).

<sup>79</sup> *Olmsted*, 134 F. Supp. 2d at 512.

<sup>80</sup> *Id.*

<sup>81</sup> *Id.* at 513 (quoting *Cannon v. University of Chicago*, 441 U.S. 677, 742 (1979) (Powell, J., dissenting)).

<sup>82</sup> *Id.*

paramount issue of congressional intent, the court rejected the plaintiffs' argument under another *Cort* factor, that they were members of the class the sections were designed to protect.<sup>83</sup> Citing *Central Bank*, the court also rejected the 1980 House report relied on so heavily by courts in previous decisions.<sup>84</sup> Because sections 80a-26(e) and 80a-27(i) had been added in 1996 to deal specifically with variable insurance contracts, the years of decisions recognizing implied rights of action under the Act did not sway the court.<sup>85</sup>

## B. THE SECOND CIRCUIT DECISION

Understandably, the plaintiffs appealed the decision to the Second Circuit -- the court that decided *Tannenbaum*, *Fogel I*, and *Fogel II*. In its March 7, 2002 opinion, the court adopted a markedly different approach than it had in years past, focusing on the seemingly basic and fundamental tenet that had been absent from many prior opinions on the subject: when determining whether Congress intended a cause of action to exist, the most telling indicator is the simple fact that Congress did not do so itself. With this "back-to-the-basics" approach, the court correctly stated that even implied rights of action under federal law do not exist unless it may be determined that Congress actually intended that they exist, "no matter how desirable that may be as a policy matter, or how compatible with the statute."<sup>86</sup> A court must begin the search for the necessary congressional intent with the text of the statute itself and "cannot ordinarily conclude that Congress intended to create a right of action when none was explicitly provided."<sup>87</sup> Because the Act did not explicitly provide for a cause of action under either of the sections at issue in *Olmsted*, the court held that a presumption existed that Congress did *not* intend to create a cause of action.<sup>88</sup> The court reasoned that this fundamental presumption was strengthened by three additional factors. The first was the fact that sections 26(f) and 27(i) do not contain "rights-creating language"; the sections provide only that certain conduct is "unlawful" and reflect no focus on the persons protected.<sup>89</sup> Second, the Act provides the SEC with authority to

<sup>83</sup> *Olmsted*, 134 F. Supp. 2d at 515.

<sup>84</sup> *Id.* at 515.

<sup>85</sup> *Id.* at 516.

<sup>86</sup> *Olmsted v. Pruco Life Ins. Co.*, 283 F. 3d 429, 432 (2d Cir. 2002) (quoting *Alexander v. Sandoval*, 532 U.S. 275, 286-87 (2001)). In an *amicus curiae* brief, the SEC declined to adopt a position on the question of the availability of private recovery under §§ 26 (e) and 27 (i). Rather, the SEC argued that the plaintiffs' claims could be adequately addressed through the express remedial scheme available under § 47 (b), which permits rescission of and restitution of amounts paid under an unlawful portion of a contract. It is not clear whether the SEC's argument reflects a shift in its position on private enforcement of the Act, or whether it reflects a hope that the court would find a way to affirm without disturbing its earlier, more fundamental decisions.

<sup>87</sup> *Id.*

<sup>88</sup> *Id.*

<sup>89</sup> *Id.* at 432-33.

enforce all its provisions; this express provision of one specific enforcement mechanism indicates congressional intent to preclude others.<sup>90</sup> Third, Congress's provision of the express remedy in section 36(b) for breaches of fiduciary duties also suggested "that omission of an explicit private right to enforce other sections was intentional."<sup>91</sup> With the addition of these three factors, the court concluded that the presumption that Congress did not intend to create a cause of action was "strong."<sup>92</sup>

The court went on to reject each of the plaintiffs' arguments raised to rebut the presumption. The plaintiffs argued that the court should not depart from the long line of cases finding implied rights under the Act.<sup>93</sup> The court stated that "when those cases were decided," the courts were without the restrictions imposed in 1975 by *Cort v. Ash*, or the reference in subsequent decisions, and had "more latitude to weigh statutory policy and other considerations."<sup>94</sup> The court also rejected the plaintiffs' "legal context" argument -- that in enacting sections 26(f) and 27(i), Congress expected and relied on courts to infer causes of action, given their past history of doing so.<sup>95</sup> The court held that context serves only to clarify ambiguous text, and the text of the 1940 Act unambiguously did not provide for a cause of action.<sup>96</sup> The plaintiffs also pointed to the 1980 House Committee Report and to a 1996 House Committee Report accompanying sections 26(f) and 27(i),<sup>97</sup> but the court rejected those sources because "[w]here the text of a statute is unambiguous, 'judicial inquiry is complete[ ] except in rare and exceptional circumstances,'" with "legislative history instructive only upon 'the most extraordinary showing of contrary intentions.'"<sup>98</sup> The 1980 report, which post-dated the Act and

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<sup>90</sup> *See id.* at 433 ("The Express provision of one method enforcing a substantive rule suggests that Congress intended to preclude others . . . . Sometimes the suggestion is so strong that it precludes a finding of congressional intent to create a private right of action, even though other aspects of the statute . . . suggest the contrary.") (quoting *Sandoval*, 532 U.S. at 290)).

<sup>91</sup> *Olmsted*, 283 F. 3d at 433.

<sup>92</sup> *Id.*

<sup>93</sup> *Id.* at 433-34.

<sup>94</sup> *Id.* at 434. The cases cited by the court in this distinction, however, all were decided after 1975, not to mention the court's own 1977 decision in *Tannenbaum* and its 1981 decision in *Fogel II*.

<sup>95</sup> *Id.* at 434-35 .

<sup>96</sup> *Olmsted*, 283 F. 3d at 435.

<sup>97</sup> The 1996 House Committee Report states that the new provisions subject variable insurance contracts to the same general prohibitions on excessive fees as mutual funds.

<sup>98</sup> *Olmsted*, 283 F. 3d at 435 (quoting *Garcia v. United States*, 469 U.S. 70, 75 (1985)).

<sup>99</sup> *Id.* (quoting *Garcia*, 469 at 75).



pre-dated sections 26(f) and 27(i), did not qualify, and the 1996 report contained no contrary indications as to remedies.<sup>100</sup>

Litigants hoping for a more fundamental and conservative approach to implied causes of action under the Act have no cause for complaint about this decision, but, in a certain light, the *Olmsted* holding is inconclusive and unsatisfying, if for no other reason than its direct contradiction with *Tannenbaum* and *Fogel II*. The critical point in the decision was a fundamental presumption that Congress' failure to provide an express cause of action reflected its intent that no such right of action exist. The reasoning behind this presumption, however, would apply to the entire Act and, thus, to the questions before the court in *Tannenbaum* and *Fogel II*. The court held that this presumption was strengthened by the facts that Congress empowered the SEC to enforce the Act and created section 36(b), but these facts also would apply to the entire Act and, thus, in *Tannenbaum* and *Fogel II*. In fact, in *Tannenbaum*, the court had stated that Congress originally had designed section 36 to expressly authorize SEC enforcement and to imply private damages actions against fiduciaries. Now, in *Olmsted*, the court has stated that Congress's specific grant of authority to the SEC is *inconsistent* with an intent to imply private enforcement authority.

The *Olmsted* court made an attempt to address these inconsistencies. As for the "long line of decisions recognizing implied private rights of action as a way of promoting the policies served by the [1940 Act],"<sup>101</sup> the court stated that those decisions were rendered at a time when courts had more leeway to consider statutory policy, rather than congressional intent.<sup>102</sup> The court correctly noted that in 1975, with *Cort v. Ash*, the Supreme Court changed the inquiry, from the simple question of whether a statute was enacted for the benefit of a particular class, to a multi-factor, structured approach.<sup>103</sup> The court also correctly noted that post-*Cort* decisions further honed the inquiry to focus predominantly on legislative intent.<sup>104</sup> The cases the court was distinguishing, however, were decided *after* 1975.<sup>105</sup> Moreover, *Cort v. Ash* predated the Second Circuit's own decision in *Tannenbaum*, and the subsequent decisions cited by the court as refining *Cort v. Ash*<sup>106</sup> pre-dated its own decision in *Fogel II*. The *Olmsted* court simply did not explain adequately why, if its decision was based on a refraining from considerations of statutory policy, that same restraint was absent from these earlier decisions.

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<sup>100</sup> *Id.*

<sup>101</sup> *Id.* at 433-34.

<sup>102</sup> *Id.* at 434.

<sup>103</sup> *Olmsted*, 283 F. 3d at 434.

<sup>104</sup> *Id.*

<sup>105</sup> See *id.* at 434 n.4 (citing cases dated from 1985 through 1998).

<sup>106</sup> *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979); *Northwest Airlines, Inc. v. Transportation Workers Union*, 451 U.S. 77 (1981).

In a footnote, the court also specifically addressed the conflict with *Fogel II*, stating that *Fogel II* was simply an “assumption” that, in enacting section 36(b) in 1970, Congress had not overruled prior judicial recognition of implied causes of action.<sup>107</sup> The Court distinguished *Fogel II* from *Olmsted* only on the grounds that *Olmsted* dealt with new sections of the Act, the implicit potential of which could not have been addressed by a court prior to 1970.<sup>108</sup> The court stated “[w]e express no opinion on the current validity of our assumption in *Fogel [III]* because in this case we interpret sections added after Congress created the private right of action in section 36(b).”<sup>109</sup> The court had cited the addition of section 36(b), however, as evidence that Congress did not intend to imply rights of action and “knew how to do so . . . expressly.”<sup>110</sup> The court seemed to hold that, under its reasoning, causes of action that already had been recognized by 1970 were valid. Surely, however, the court could not be suggesting that Congress only learned “how to do so” between the 1940 legislation and the 1970 amendments. In any event, the court’s holdings in *Fogel II* and *Tannenbaum* obviously were not supported solely by a finding that the addition of section 36(b) did not completely overrule prior decisions. Those decisions built on earlier rulings that private rights in fact existed, and those earlier rulings were based on reasoning rejected in *Olmsted*. Thus, even accepting this strained effort to leave *Fogel II* intact, given the fundamental and broad-ranging reasoning supporting the *Olmsted* opinion, it stands in stark contrast to, and seriously undermines, *Tannenbaum* and *Fogel II*.

The inconsistency of the *Olmsted* opinion, or at least the failure of the *Olmsted* court to state expressly that its holding constituted a shift away from opinions like *Tannenbaum* and *Fogel*, is exacerbated by another Second Circuit decision handed down only a week before *Olmsted*. In *Strougo v. Bassini*,<sup>111</sup> the issue was not the existence of private rights under the Act, but rather whether the plaintiffs had individual standing to bring direct claims, as opposed to derivative claims, under sections 36(a), 36(b), and 48 of the Act.<sup>112</sup> In applying Maryland law to that question, however, the court reviewed the policy objectives underlying the 1940 Act to determine whether Maryland shareholder standing law conflicted with those policies.<sup>113</sup> The court held that “the potential availability of direct action” was consistent with the general policies of the Act, and that the plaintiff’s allegations supported direct claims under sections 36(a), 36(b), and 48. Like the sections at issue in *Olmsted*, however, section 48 provides only that certain conduct is “unlawful,” and section 36(a) provides only that the SEC is authorized to

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<sup>107</sup> *Olmsted*, 283 F. 3d at 434 n.4.

<sup>108</sup> *Id.* at 433 n.3.

<sup>109</sup> *Id.*

<sup>110</sup> *Id.* at 433 (quoting *Touche Ross*, 442 U.S. at 572).

<sup>111</sup> 282 F. 3d 162 (2d Cir. 2002).

<sup>112</sup> *Strougo*, 282 F. 3d at 169.

<sup>113</sup> *Id.* at 174-76.

bring civil actions; neither contains “rights-creating language” as defined by *Olmsted*.<sup>114</sup> The grant of authority to the SEC that, to the *Olmsted* court, evidenced congressional intent against private rights of action applies equally to section 48 and especially to section 36(a), which itself is a specific grant of authority to the SEC.<sup>115</sup> Again, the question of the general availability of private suit under these sections was not technically at issue on appeal in *Strougo*, but one would think that Circuit Judge Sack, who himself would author the *Olmsted* decision one week later, would at least have commented on the issue in *Strougo* before allowing such claims to proceed.

## V. CONCLUSION

In its fundamental analysis, and in its result, the *Olmsted* court appears to have gotten it right. The court honed in on a crucial distinction glossed over by courts interpreting the 1940 Act and other statutes for years: the distinction between the term “implied” and the term “inferred.” An “implied” private right of action must indeed be implied; it must actually be communicated by Congress, albeit indirectly. Only Congress can “imply” a right of action; for years, despite the commonly-used phrase, courts had not really been “implying” rights of action, but rather “inferring” them, drawing their own conclusions from the evidence or circumstances surrounding actual congressional statements. In fact, as the *Olmsted* court recognized, courts had moved beyond mere inference, which at least centers on Congress’s intent, and had begun simply determining whether private rights of action were consistent with the policies and goals of a particular statute. *Olmsted* adhered to the fundamentals, as *Cort v. Ash* had taught: if Congress did not specifically intend the existence of a right of action, no such right could exist. And, as *Central Bank* had taught, courts may not perform intellectual gymnastics or rely on circumstantial evidence to glean congressional intent. In fact, if Congress did not itself create a right of action, and if the presumption that leads from that fact is strengthened by other evidentiary factors, the inquiry essentially should end, absent unique and extraordinary indicators to the contrary.

Constrained by the issue before it, however, the *Olmsted* court could only go so far. The court rested its decision on principles at odds with the principles supporting earlier decisions concerning other sections of the very same act. To the extent it attempted to explain the incongruence, its efforts, inevitably, were unsuccessful. The importance of the 1970 amendments in the *Olmsted* court’s limitation of its holding is a stretch, and is inconsistent. As *Central Bank* taught, the addition of section 36(b) meant nothing in terms of congressional intent, other than the fact that that Congress desired to create a specific fiduciary duty with respect to compensation and an express private right of action for breaches of that duty. *Fogel II* was right on this point -- the addition of section 36(b) does not equal congressional overruling of those implied private actions already recognized by the courts. Nor did it evidence congressional acceptance of that practice, however, and more importantly, it evidenced absolutely nothing about the intentions of the 1940 Congress intentions with respect to private rights under the Act. Even Congress’s warning that the addition of section 36(b) did not imply any effect on section

<sup>114</sup> *Olmsted*, 283 F. 3d at 432; see 15 U.S.C. § 80a-35 (a); 15 U.S.C. § 80a-47.

<sup>115</sup> See *Olmsted*, 283 F. 3d at 433; 15 U.S.C. § 80(a)-36(a).

36(a) says only just that: it says nothing about implied rights of action, it means nothing at all about the remainder of the Act, and, even if it were an acceptance of implied rights under the Act, it says nothing about the intentions of the 1940 Congress on that subject.

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