No. 15-134

IN THE

Supreme Court of the United States

SCHWAB INVESTMENTS, *et al.*,

Petitioners,

v.

NORTHSTAR FINANCIAL ADVISORS, INC.,
ON BEHALF OF ITSELF AND OTHERS
SIMILARLY SITUATED,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF MUTUAL FUND DIRECTORS FORUM AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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INTEREST OF *AMICUS CURIAE*[1]

The Mutual Fund Directors Forum is an independent, non-profit membership organization established to serve as an important vehicle for the continuing education of the independent directors of investment companies in the United States, to recommend improvements and best practices in mutual fund governance, and to provide independent directors with a voice in key policy issues affecting the mutual funds they oversee and the shareholders they represent.

The Forum is financially independent from the advisory firms that sponsor and manage mutual funds, and membership in the Forum is limited to the independent directors of U.S. registered investment companies. The Forum's current membership comprises boards of 122 fund complexes who collectively manage trillions of dollars in assets, and each member board has a seat on the Forum's Steering Committee.[2] The views expressed in this *amicus* brief have been reviewed by the Steering Committee and approved by the Forum's Board of Directors.

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[1] No counsel for any party has authored this brief in whole or in part, and no party or counsel for a party has made a monetary contribution to the preparation or submission of this brief. *See* Sup. Ct. R. 37.6. Counsel of record for all parties received notice at least 10 days prior to the due date of the *amicus curiae*'s intention to file this brief and consented to the filing of this brief.

[2] A list of the Forum's current members is annexed hereto as Appendix A.

The Forum is particularly attentive to any changes in the law that will increase the costs to shareholders of operating mutual funds, reduce the ability of mutual funds to implement the best investment strategies most efficiently, or otherwise work against the best interests of fund investors.

As the voice of independent professionals who serve on fund boards, the Forum is uniquely well positioned to address these issues. Far from being mere "puppets" of the investment adviser, as the Ninth Circuit incorrectly asserted, App. at 66a,[3] independent fund directors were entrusted by Congress to serve as "independent watchdogs" with principal responsibility for overseeing investment advisers and safeguarding investor interests. Consistent with its mission to promote the work of independent directors in their important role in mutual fund oversight, the Forum therefore submits this brief to assist the Court in understanding how, for funds, directors, and investors alike, the negative effects of the decision below will be both far-reaching and profound.

SUMMARY OF ARGUMENT

In holding that mutual fund investors may pursue a private common law action in "contract" for alleged violations of Section 13(a) of the Investment Company Act of 1940 ("ICA"), the decision below represents a dangerous departure from decades of legislation and jurisprudence concerning the need for uniform federal regulation of the national securities markets and conflicts with the rulings of multiple courts that there is

[3] "App." refers to Petitioners' Appendix A.

no implied private right of action to enforce the federal securities laws, including the ICA. If left to stand, the decision will work to the detriment of fund investors nationwide by driving up the cost of fund operations and discouraging qualified professionals from serving on fund boards.

"No issuer of securities is subject to more detailed regulation than a mutual fund." *U.S. v. National Ass'n of Sec. Dealers, Inc.*, 422 U.S. 694, 734 n.45 (1975) (citing Letter from Ray Garrett, Jr., Chairman, SEC, to Sen. John Sparkman, 1974 Staff Report at v (Nov. 4, 1974)). In addition to the disclosure obligations all issuers must satisfy, the ICA imposes unique requirements on the operations of investment companies because mutual fund offerings are "inherently national in nature," and are appropriately "subject to *only* Federal regulation." H.R. Rep. No. 104-864, at 40 (1996) (Conf. Rep.) (emphasis added). The decision below is wholly inconsistent with this regulatory framework, which rests on the primacy of federal law to provide for a uniform national regulatory scheme.

The decision below also runs afoul of the settled rule that there is no implied right of action under the federal securities laws absent congressional intent and with the rulings of numerous other courts applying that rule—including a different panel of the Ninth Circuit in this very case—that have declined to imply a private right of action under the ICA. No end-run around that rule, whether on the theory that a prospectus is a "contract" or otherwise, is or should be permitted.

The negative consequences that are sure to flow if the decision of the Ninth Circuit is left to stand cannot be overstated. Mutual funds are the principal vehicle for saving and investing in the United States, with over 90 million Americans investing nearly $16 trillion in over 9,000 different funds. *See* Investment Company Institute, *2015 Investment Company Fact Book* 22, 26, 114 (2015).[4] Investors already have multiple means at their disposal to seek relief for disclosure-related violations, including for the very harms respondent has alleged in this case. Allowing contract actions based on the disclosures contained in the thousands of fund prospectuses issued every year is not only unnecessary, it is certain to yield a patchwork of conflicting obligations under the laws of different jurisdictions and to increase the costs of mutual fund operations—all to the detriment of investors to whom those costs will be passed in the form of higher fees and expenses. Effective fund governance will also be compromised because the Ninth Circuit's decision undermines the fundamental role fund directors play in the regulatory scheme of protecting shareholders' interests. Because the harms to funds and their investors will be both immediate and severe, this Court should not wait for them to multiply before granting review.[5]

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[4] *Available at* http://www.icifactbook.org/pdf/2015_factbook.pdf.

[5] While this brief focuses on the question presented concerning the Ninth Circuit's novel breach-of-contract theory, the Forum also supports the petition as to the standing question because the Ninth Circuit's standing decision is in clear conflict with the decisions of

ARGUMENT

I. *CERTIORARI* IS WARRANTED BECAUSE THE DECISION BELOW CONTRAVENES SETTLED FEDERAL LAW AND POLICY ON MUTUAL FUND REGULATION.

In its opinion below, the Ninth Circuit reasoned that a prospectus constitutes a "contract" with investors who purchase fund shares, such that, where a fund strayed from its fundamental investment objective as described in its prospectus without shareholder vote, investors may bring a direct action in contract to remedy that alleged wrong. App. at 48a-49a. That decision is not only inconsistent with the comprehensive federal scheme established by Congress for the regulation of the national securities markets, it also breaks with the multiple decisions of this Court limiting when private rights of action under the federal securities laws may be implied, with the rulings of other courts that there is no private right of action under the ICA, including Section 13(a), and indeed with the many courts that have soundly recognized that the issuance of a federally mandated disclosure document is not a "contract" enforceable in a private action for breach.

other Circuits, with this Court's precedents, and is an issue of national importance.

A. The Regulation Of Investment Companies Is A Federal Matter Governed By Federal Law.

Since 1933, Congress has manifested its intent in clear and unequivocal terms that, with some limited exceptions not relevant here, the regulation of the national securities markets is a matter of federal law and that securities claims be tried in federal court. In the face of uneven and ineffective state regulation, Congress enacted several statutes during the New Deal designed to regulate securities comprehensively on a national level, including the Securities Act of 1933 ("1933 Act"), the Securities Exchange Act of 1934 ("1934 Act"), the Investment Advisers Act of 1940 ("IAA"), and the ICA. Together, these interrelated statutes were intended to "complete an integral regulatory scheme" and were a significant part of the efforts "to stimulate the economy and restore confidence in the capitalist system." Elisabeth Keller & Gregory A. Gehlmann, *A Historical Introduction to the Securities Act of 1933 and the Securities Exchange Act of 1934*, 49 OHIO ST. L.J. 329, 330 (1988).

Over the past 20 years, as shortcomings in its effort to federalize securities regulation became manifest, Congress acted to further reduce the role of state law and state courts in this nationally important arena. In 1995, Congress enacted the Private Securities Litigation Reform Act, Pub. L. No. 104-67, 109 Stat. 737, to combat "perceived abuses of the class-action vehicle in litigation involving nationally traded securities" and to prevent "the class-action device [from] being used to injure 'the entire U.S.

economy.'" *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 81 (2006). In 1996 Congress acted again, passing the National Securities Markets Improvement Act, Pub. L. No. 104-290, 110 Stat. 3416, which further codified the primacy of federal regulation of the national securities market by, among other things, preempting the review of mutual fund prospectuses by the states. Thomas P. Lemke, *et al.*, *Regulation of Investment Companies* § 2.05[3] (2015). And, with the enactment of the Securities Litigation Uniform Standards Act ("SLUSA") in 1998, Pub. L. No. 105-353, 112 Stat. 3227, Congress reaffirmed its commitment to enforcing "uniform national rules for securities class action litigation involving our national capital markets," H.R. Rep. No. 105-640, at 8, 9 (1998), by "limit[ing] the availability of remedies under state law," *Dabit*, 547 U.S. at 88 n.13.[6]

Each time Congress acted it did so with a singular, critical purpose: to "'maintain uniformity and certainty' in U.S. securities markets," Rachel Witmer, *Litigation Reform: Gramm, Domenici, Dodd Introduce Bill To Federalize Securities Class Actions*, 29 Sec. Reg. & L. Rep. (BNA) 1401, 1402 (1997), so as to "enhance capital formation" and promote the "competitiveness of the American economy,"

[6] By contrast, the sweeping reforms introduced by the Dodd-Frank Act focused on areas of the financial system *other than* investment companies, and provided no room for expanded state regulation of mutual funds. *See, e.g.*, Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 913-14, 916-17, 124 Stat. 1376, 1824-30, 1833-37 (2010).

Statement on Signing the National Securities Markets Improvement Act of 1996, 2 PUB. PAPERS 1812 (Oct. 11, 1996). *See also* H.R. Rep. No. 104-622, at 16 (1996) (recognizing that uniform federal laws "promote efficiency, competition, and capital formation in the capital markets," and "advance the development of national securities markets").

"The magnitude of the federal interest in protecting the integrity and efficient operation of the market for nationally traded securities" cannot be overstated. *Dabit*, 547 U.S. at 78; *see also* H.R. Rep. No. 104-864, at 40 (1996). And nowhere is that interest more compelling than in the mutual fund area. Building on the disclosure regime instituted by the 1933 and 1934 Acts, Congress opted to impose additional and unique requirements upon investment companies via the ICA to better ensure that investor interests be appropriately safeguarded. The result of this unique "combination of regulatory constraints" imposed on mutual funds, coupled with the "contractual innovation most distinctive to the mutual fund industry"—*i.e.*, redeemable shares—has created the conditions necessary for competition among mutual funds to thrive. John C. Coates IV & R. Glenn Hubbard, *Competition in the Mutual Fund Industry: Evidence and Implications for Policy*, 33 J. CORP. L. 151, 213 (2007).

The Ninth Circuit's opinion does not acknowledge any of this. Indeed, nowhere in the Ninth Circuit's opinion is any reference to the federal government's role as the "exclusive regulator" of mutual funds to be found. H.R. Rep. No. 104-622 at 16 (1996). Instead, the principal authority for the Ninth Circuit's ruling is a concurring opinion in *Trustees of Dartmouth College v. Woodward*, 17 U.S. 518 (1819), a case that was (i) decided over a century before Congress first began regulating the national securities market in a comprehensive manner in 1933, and (ii) did not involve securities, let alone mutual fund shares, at all. The decision of the Ninth Circuit is therefore inconsistent with established law and policy that securities regulation, particularly with respect to investment companies, is a federal matter.

B. A Federally Mandated Prospectus Is Not A "Contract" Enforceable Under Common Law.

As both Congress and this Court have long understood, state law and state courts have frequently been deployed to evade the strictures of the federal securities laws and the limits on litigation (both substantive and procedural) they impose. *See Dabit*, 547 U.S. 71; SLUSA, Pub. L. No. 105-353. Whether based in state law contract principles or otherwise, courts across the country have rightly rejected these evasive maneuvers, including the Courts of Appeals for the Fifth, Seventh and Ninth Circuits. *See, e.g.*, *In re Intelogic Trace, Inc.*, No. 97-50932, 1999 WL 152944, at *1 (5th Cir. Feb. 22, 1999) (holding allegation of "failure to abide by commitments" made "in the Prospectus" insufficient to state a cause of action because "the Prospectus was not a contract"); *Kurz v. Fidelity Mgmt. & Research Co.*, 556 F.3d 639, 642 (7th Cir. 2009) (stating that a potential, SEC-enforceable ICA violation "is some distance from a state-law contract action" and the plaintiff "had a federal securities claim, or he had nothing"); *Cohen v. Stratosphere Corp.*, 115 F.3d 695 (9th Cir. 1997) (finding a prospectus was not a contract); *McKesson HBOC, Inc. v. N.Y. St. Common Ret. Fund, Inc.*, 339 F.3d 1087 (9th Cir. 2003) (holding that a prospectus was neither a contract nor an offer to enter into a contract).

Those decisions are fully supported by the language of the ICA itself. Had Congress intended to treat a mutual fund "prospectus" as a "contract" it surely would have said so. But even a cursory reading of the ICA shows that this is not the case. The ICA uses the word "contract" 69 times in connection with 12 different provisions—including Section 15 which expressly deals with advisory contracts—none of them having anything to do with a prospectus. 15 U.S.C. §§ 80a-2, 3, 4, 9, 15, 17, 18, 26, 27, 35, 41, 46 (2013). Likewise, the ICA uses the word "prospectus" 18 times in connection with three different provisions, none of them having anything to do with a contract. *Id.* §§ 80a-2, 22, 24. Instead, the ICA defines "prospectus" by reference to Section 10(a) of the 1933 Act. *Id.* § 80a-2(a)(31). Section 10(a), in turn, nowhere uses the term "contract," nor does any standard dictionary in use at the time the ICA was enacted define the word "prospectus" in contractual terms. *See, e.g.*, BLACK'S LAW DICTIONARY 959 (2d ed. 1910) (defining a prospectus as "[a] document published by a company or corporation, or by persons acting as its agents or assignees, setting forth the nature and objects of an issue of shares, debentures or other securities created by the company or corporation, and inviting the public to subscribe to the issue"); THE CYCLOPEDIC LAW

DICTIONARY 892 (3d ed. 1940) (same); WEBSTER'S REVISED UNABRIDGED DICTIONARY 1151 (1913) (defining a prospectus as "[a] summary, plan, or scheme of something proposed, affording a prospect of its nature; especially, an exposition of the scheme of an unpublished literary work"). And when called upon to interpret the meaning of the word "prospectus" under Section 10(a), this Court did not refer to a "prospectus" as a contract either. To the contrary, *Gustafson v. Alloyd Co.*, 513 U.S. 561, 584 (1995), held that a private contract was *not* a prospectus under Section 12(2) of the 1933 Act.

No mention of any of these statutory provisions is made in the decision below, nor of other ICA provisions whose application would be rendered meaningless under the Ninth Circuit's novel approach. Under Section 47, for example, a "contract" that is "made, or whose performance involves, a violation of [the ICA], or of any rule, regulation or order thereunder," is "unenforceable" unless the court orders otherwise. 15 U.S.C. § 80a-46(b)(1). If a prospectus were a "contract" involving a "violation" of the ICA, as the Ninth Circuit concluded here, then the prospectus would be "unenforceable" under Section 47. But to deem a prospectus "unenforceable" makes no sense. A prospectus is fundamentally a *disclosure* document whose purpose is to provide information to investors in plain English, not a binding legal agreement for the purchase and sale of a security that can be set aside for breach. *See* 15 U.S.C. § 80a-8(b); 17 C.F.R. § 274.11A (2015). If declared "unenforceable," a prospectus would cease to perform its essential purpose, all to the detriment of investors, for whose benefit such disclosures are required in the first place. Nothing in the language of Section 47 or its legislative history so much as hints that Congress intended that peculiar result.

C. No Private Right Of Action To Enforce Section 13(a) Of The ICA Directly Or Indirectly May Be Implied.

Where the text of a federal statute does not expressly authorize a private right of action, congressional intent determines whether such a right should be implied. *Alexander v. Sandoval*, 532 U.S. 275, 288 (2001). Applying that conceptual framework, this Court has repeatedly rejected attempts to create or enlarge implied rights of action under the federal securities laws. *See, e.g.*, *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994); *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148 (2008); *Morrison v. Nat'l Australia Bank Ltd.*, 561 U.S. 247 (2010); *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011); *Transamerica Mortg. Advisors, Inc. v. Lewis*, 444 U.S. 11, 19 (1979).

Since *Sandoval*, no court—including the Courts of Appeals for the Second, Third, and Sixth Circuits, and multiple district courts as well—has recognized an implied private right of action under the ICA. *See, e.g.*, *Bellikoff v. Eaton Vance Corp.*, 481 F.3d 110 (2d Cir. 2007) (no private right of action under Sections 34(b), 36(a) or 48(a) of the ICA); *Olmsted v. Pruco Life Ins. Co. of N.J.*, 283 F.3d 429 (2d Cir. 2002) (no private right of action under Sections 26(f) and 27(i) of the ICA);

Santomenno ex rel. John Hancock Trust v. John Hancock Life Ins. Co. (U.S.A.), 677 F.3d 178 (3d Cir. 2012) (no private right of action under Section 47(b) of the ICA); *Laborers' Local 265 Pension Fund v. iShares*, 769 F.3d 399 (6th Cir. 2014) (no private right of action under Section 36(a) of the ICA); *Mutchka v. Harris*, 373 F. Supp. 2d 1021, 1026 (C.D. Cal. 2005) ("[C]ases decided after *Sandoval* have refused to find an implied private right of action in the ICA."). Indeed, no court to consider the question since *Sandoval*—including a different panel of the Ninth Circuit—has held that a private right of action to enforce the shareholder vote provisions of Section 13(a) of the ICA may be implied. *See Northstar Fin. Advisors, Inc. v. Schwab Invs.*, 615 F.3d 1106 (9th Cir. 2010) (no implied private right of action under Section 13(a)); *In re Regions Morgan Keegan Sec., Derivative, and ERISA Litig.*, 743 F. Supp. 2d 744, 761-62 (W.D. Tenn. 2010) (same); *In re Oppenheimer Rochester Funds Grp. Sec. Litig.*, 838 F. Supp. 2d 1148, 1159 (D. Colo. 2012) (same).

Sandoval, properly applied, admits of no other result. The unambiguous terms of Section 13(a) make clear that it is not meant "to confer rights on a particular class of persons," *Sandoval*, 532 U.S. at 289, but rather is "focused on limiting the types of actions an *investment company* can take without first obtaining shareholder approval," *Northstar*, 615 F.3d at 1115 (emphasis added). Nor is there anything else in the ICA that suggests Congress intended to imbue private parties with the power to enforce its terms. To the contrary, under Section 42, it is the "Commission" who may "bring an action" to enforce compliance with the ICA and to seek relief for its violation. 15 U.S.C. § 80a-41. That Congress intended to confine the statute's remedial authority to the SEC is further buttressed by the explicit recognition of a private right of action under Section 36(b), the only such ICA provision to include rights-granting language. 15 U.S.C. § 80a-35(b) ("An action may be brought under this subsection … *by a security holder* of such registered investment company….") (emphasis added). Because "Congress knew how to create a private right of action to enforce a particular section of the Act when it wished to do so," and did so only with respect to Section 36(b), there can be no implied private right of action to enforce the shareholder vote provision of Section 13(a). *Northstar*, 615 F.3d at 1117.

The Ninth Circuit proceeded as if Congress had not spoken, *Sandoval* were never decided, and the decisions of other Circuits holding that there is no private right of action to enforce the ICA did not exist. That was patently wrong. Allowing private enforcement of Section 13(a) under the rubric of a contract claim directly evades the clear prohibition on private rights of action under federal law. *See Astra USA, Inc. v. Santa Clara Cnty.*, 131 S. Ct. 1342, 1347-49 (2011) ("The absence of a private right [of action] to enforce the statutory … obligations would be rendered meaningless if [plaintiffs] could overcome that obstacle by suing to enforce the [prospectus as a contract] instead."); *Grochowski v. Phoenix Constr.*, 318 F.3d 80, 86 (2d Cir. 2003) ("plaintiffs' efforts to bring their claims as state common-law [contract] claims are clearly an impermissible 'end run' around the [Davis-Beacon] Act," which accords no private right of action); *Broder v. Cablevision Sys. Corp.*, 418 F.3d 187, 198 (2d Cir. 2005) ("a federal court should not strain to find in a contract a state-law right of action for violation of a federal law under which no private right of action exists").

II. THE NEGATIVE EFFECTS OF THE NINTH CIRCUIT'S NOVEL AND UNNECESSARY CONTRACT-BASED THEORY OF LIABILITY WILL BE DRAMATIC AND SWEEPING.

Existing law provides mutual fund investors with ample means to seek redress for injuries they may suffer, whether at the hands of the funds in which they invest, the advisers who advise them, or the independent directors who oversee them. Under the federal securities laws, for instance, a shareholder may sue the fund, the directors, and "control persons" of the adviser for any material misstatements or omissions in a prospectus. 15 U.S.C. § 77k(a) (2013). Shareholders also have avenues of relief available to them under state law, including direct and derivative claims for breach of fiduciary duty against the directors and others, as the circumstances may permit. *See, e.g.*, SLUSA, Pub. L. No. 105-353 (permitting otherwise covered class actions for breach of fiduciary duty to proceed under state law pursuant to the "Delaware carve-out"); *Burks v. Lasker*, 441 U.S. 471, 486 (1979) (holding that state law governs "the authority of independent directors to discontinue derivative suits to the extent such law is consistent with the policies of the ICA and IAA"); *Green v. Fund Asset Mgmt., L.P.*, 286 F.3d 682, 683 (3d Cir. 2002) (involving direct suit by shareholders claiming violation of "fiduciary duties under the ICA and state law"). Further, investors who purchased through broker-dealers and registered representatives can also seek recourse through the Financial Industry Regulatory Authority ("FINRA"). *See* FINRA Rule 2210. Thus, even leaving aside SEC enforcement authority, federal and state law already provide a full panoply of rights and remedies to shareholders who believe they have been wronged, including for the harms supposedly done in this case.

The Ninth Circuit did not confront why there was any need to recognize a novel claim for relief sounding in contract, given the absence of any remedial "gap." Instead, it blithely embraced a new theory of liability that has generated unnecessary controversy and confusion and whose negative effects thereafter to be felt for years to come.

A. The Ninth Circuit's Decision Will Foster Needless Litigation And Drive Up Fund Costs.

The ICA and the rules and regulations promulgated thereunder require mutual funds to issue a prospectus reflecting the information specified in Form N-1A, which sets out detailed requirements regarding the contents of all mutual fund prospectuses. 17 C.F.R. §§ 230.485, 230.497 (2015); SEC Form N-1A. Because most mutual funds issue shares continually, most need to update their disclosures continually as well. These unique aspects of mutual fund prospectuses make any analogy to contract strained at best. Legally cognizable contracts are formed *only* where there is a meeting of the minds between the parties and mutual assent, RESTATEMENT

(SECOND) OF CONTRACTS § 17 (1981), not when one party is constrained by a stranger to the contract to include certain terms in the agreement and simultaneously free to change other terms of the parties' bargain unilaterally and without its counterparty's consent, *Contractors Equip. Maint. Co. ex rel. U.S. v. Bechtel Hanford, Inc.*, 514 F.3d 899, 905 (9th Cir. 2008) ("[o]ne party cannot unilaterally modify a contract without the consent of the other party").

But the problems with the Court of Appeals' approach do not stop there. Contracts are principally creatures of state law, which differs significantly in respect of such fundamental issues as choice of law, statutes of limitation, and the ability of third-party beneficiaries to sue and be sued. *See, e.g.*, *In re Payless Cashways*, 203 F.3d 1081, 1084 (8th Cir. 2000) ("states could have differing rules regarding the construction of a contract"); *Czewski v. KVH Indus. Inc.*, 607 F. App'x 478, 480 (6th Cir. 2015) ("Michigan has a six-year statute of limitations for breach of contract actions … and Rhode Island has a ten-year statute of limitations"); *Rando v. Gov't Emps. Ins. Co.*, 556 F.3d 1173, 1176 (11th Cir. 2009) ("Florida follows the 'lex loci contractus' choice-of-law rule, which 'provides that the law of the jurisdiction where the contract was executed governs the rights and liabilities of the parties'"); *Fin. One Pub. Co. v. Lehman Bros. Special Fin., Inc.*, 414 F.3d 325, 336 (2d Cir. 2005) ("New York courts apply the 'center of gravity' or 'grouping of contacts' choice of law theory"). Thus, depending on where the contract was negotiated, where the contract was performed, where the breach took place, and where the harm was felt (among other potential factors), any "contract" based on a fund disclosure could conceivably be governed by different state laws with different substantive and procedural rules depending on the individual facts of any given case.[7]

Further, because mutual fund disclosures are neither static nor confined to the prospectus, and because the Ninth Circuit declined to resolve whether the "contract" at issue was express or implied, App. at 38a, its approach means there are literally countless "contracts" in effect with fund shareholders at any given time, each with terms that would need to be established through individual proof. Under SEC rules, funds must update their prospectuses on an annual basis and whenever there is a material change. 15 U.S.C. § 77j(a)(3); 17 C.F.R. § 230.485(a)-(b). Funds must also issue a "statement of additional information" ("SAI"), an additional disclosure document that is meant to furnish information beyond what is "necessary to enable an average or typical investor to understand the particular characteristics of the Fund." SEC Form N-1A, General Instructions C(1)(c), C(2)(b). While the Ninth Circuit was "not prepared to assume that the SAI itself was sufficient to provide adequate notice," it acknowledged that "there may be sophisticated shareholders" who read it with care. App. at 52a-53a. If that is so, however, every contract case predicated on a prospectus disclosure would necessarily turn not only on which

[7] The Ninth Circuit did not indicate whether the contract was governed by state law (and if so, which state) or federal law. App. at 48a-49a.

prospectus was operative at any given time, but also on what any given shareholder knew or understood from the SAI, as that would bear directly on what the terms of the parties' so-called "agreement" actually were.

Under the Ninth Circuit's approach, funds and/or their directors could thus be faced with virtually limitless fact-based contract claims in different jurisdictions with different rules and different prospects for relief, with little opportunity for resolving them pretrial without incurring significant burden and expense. *Compare* App. at 46a ("the parties to the contract at issue in this case are the Trustees and the shareholders of the Fund") *with* App. at 49a (the contract was "between the shareholders on the one hand and the Fund and the Trust on the other"). Such a result is not only antithetical to Congress's directive that the regulation of the securities markets should be uniform and that no state should be able to "impose the risks and costs of its peculiar litigation system on all national issuers," S. Rep. No. 105-182 (1998), its economic consequences will be both immediate and profound. Shareholders will be universally harmed because, regardless of whether their fund prevails in litigation, or even gets sued at all, the costs of increased insurance and other liability limiting or avoidance measures will ultimately be passed on to them.

B. The Ninth Circuit's Decision Undermines the Critical and Statutorily-Mandated Role of Independent Directors to Protect Shareholder Interests.

The Ninth Circuit's faulty schematic will also impede effective fund governance. According to the Ninth Circuit, independent fund directors are "essentially puppets of the investment adviser" who "cannot seriously be expected" to put the best interests of funds and their investors first. App. at 66a. Relying on a single newspaper article, the Court suggested that independent directors were not truly independent at all and could not be trusted to exercise their independent business judgment as a fiduciary should. *Id.* ("the definition of 'independent' is fairly loose when it comes to fund board members").[8] In doing so, however, the Ninth Circuit turned federal law on its head.

Under the ICA, fund directors play a unique and fundamental role in protecting the interests of fund shareholders. With the enactment of the ICA, Congress instituted a scheme whereby the guardianship of mutual funds and the interests of fund shareholders were entrusted to independent directors. *Burks*, 441 U.S. at 485 ("Congress entrusted to the independent directors … the primary responsibility for looking after the

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[8] The ICA contains a specific and robust definition of disinterested directors, 15 U.S.C. §§ 80a-10(a), 2(a)(19), which has been supplemented by SEC interpretative guidance. *See* Interpretive Matters Concerning Independent Directors of Investment Companies, Investment Company Act Release No. 24,083, 64 Fed. Reg. 59,877 (Nov. 3, 1999) ("Independent Directors").

interests of the fund's shareholders…."); *see also* Independent Directors, 64 Fed. Reg. 59,877. Although Congress was fully cognizant of the potential for conflicts of interest between mutual funds and their investment advisers at the time (and since), it concluded nevertheless that fund boards could adequately protect the interests of mutual funds and their shareholders and that the responsibility for that important function properly rested with them. The ICA and the rules and regulations adopted thereunder thus task the independent directors with "a host of special responsibilities," *Burks*, 441 U.S. at 482-83, including overseeing the fund's compliance program and meeting independently with the fund's chief compliance officer, approving certain distribution plans, overseeing fair valuation determinations, proxy voting, and fund disclosure, monitoring investment performance, risk management, custody of assets and shareholder services, annually evaluating and approving the fund's advisory contract, selecting and nominating other independent directors, and representing the interests of the fund's shareholders. See 17 C.F.R §§ 270.12b-1, 270.38a-1; Compliance Programs of Investment Companies and Investment Advisers, Investment Advisors Act Release No. 2204, Investment Company Act Release No. 26,299, 81 SEC Docket 2775 (Dec. 17, 2003).

In vesting independent directors with this broad responsibility, Congress intended that they serve as "'independent watchdogs' [charged with] furnish[ing] an independent check upon the management of funds and provid[ing] a means for the representation of shareholder interests in fund affairs." *See Burks*, 441 U.S. at 484 (quoting *Tannenbaum v. Zeller*, 552 F.2d 402, 406 (2d Cir. 1977) and *Investment Trusts and Investment Companies: Hearings on H.R. 10065 Before a Subcomm. of the Comm. on Interstate and Foreign Commerce*, 76th Cong. 109 (1940) (statement of David Schenker, Chief Counsel, SEC Investment Trust Study)). Neither Congress nor the SEC has lost sight of this vision since the ICA was first enacted. Indeed, over the last 20 years, the SEC has continually emphasized and enhanced the role of fund directors. For example, in a series of releases issued in 1999, the SEC "reaffirm[ed] the important role that independent directors play in protecting fund investors, strengthen[ing] their hand in dealing with fund management, [and] reinforce[ing] their independence…." Role of Independent Directors of Investment Companies, Securities Act Release No. 7754, Exchange Act Release No. 42,007, Investment Company Act Release No. 24,082, 64 Fed. Reg. 59,827 (proposed Nov. 3, 1999); Independent Directors, 64 Fed. Reg. 59,877.

This Court has embraced the principle that mutual fund oversight properly resides with fund boards, just as Congress intended. In *Jones v. Harris Associates L.P.*, for example, this Court rejected the argument that fund board approval of investment adviser compensation was irrelevant to whether advisory fees were "excessive" within the meaning of Section 36(b) of the ICA, reasoning that, "if the disinterested directors considered the relevant factors, their decision to approve a particular fee agreement is entitled to considerable weight, even if a court might weigh the factors differently." 559 U.S. 335, 351 (2010). In *Burks*, this Court likewise rejected the proposition that fund shareholders, not fund directors, should determine whether litigation is in the best interests of funds. "Congress surely would not have entrusted such critical functions as approval of advisory contracts and selection of accountants to the statutorily disinterested directors," the Court stated, "had it shared the Court of Appeals' view that such directors could never be 'disinterested'…." 441 U.S. at 485 n.15. As such, the Court reaffirmed the authority of disinterested trustees to manage fund affairs: "[I]t would have been paradoxical for Congress to have been willing to rely largely upon [boards as] 'watchdogs' to protect shareholder interests and yet, where the 'watchdogs' have done precisely that, require that they be totally muzzled." *Burks*, 441 U.S. at 485.

Today, the composition of most mutual fund boards far exceeds the minimum standards for independence and impartiality set by statute.[9] Independent directors occupy three-quarters of the board seats in more than 90 percent of mutual fund complexes. *See* Independent Directors Council, *Overview of Mutual Fund Governance* (2015).[10] Ninety-seven percent of these

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[9] The ICA requires that at least 40 percent of mutual fund boards be comprised of individuals who are not "interested persons," a broadly defined term that includes "affiliated persons" of its adviser, their family members, and others deemed by the SEC to have a material business or professional relationship with the company. *See* 15 U.S.C. §§ 80a-10(a), 2(a)(3) & (19).

[10] *Available at* http://www.idc.org/idc/issues/governance/overview_fund_gov_idc.

independent directors have never been employed by the fund complex. *Id.* Additionally, 88 percent of fund boards have an independent director serving as the board's chair or as lead independent director. *Id.*; *see also* Mutual Fund Directors Forum, *Practical Guidance for Mutual Fund Directors* 3 (2013)[11] (recommending that fund boards be "composed of at least 75 percent independent directors," notwithstanding the statutory minimum, in order to "facilitate the board's independence"). The notion that independent directors are mere "puppets" who act at the behest of the adviser and cannot be trusted to faithfully discharge the responsibility entrusted to them by statute, as the Ninth Circuit opined, thus contravenes Congress's intent and lacks any empirical support.

The consequences of creating new and unnecessary causes of action against independent fund directors—the very individuals upon whose ongoing business judgment the regulatory system relies for the protection of shareholders' interests—will be far-reaching and severe. Almost 100 million Americans trust fund directors to oversee the trillions of dollars they have invested in thousands of funds nationwide. The American public depends on knowledgeable, qualified people to oversee fund operations and protect investor interests. Worthy individuals will have little incentive to serve, however, where doing so means jeopardizing their professional reputations and putting themselves at economic risk.

[11] *Available at* http://www.mfdf.org/images/uploads/newsroom/MFDF_Practical_Guidance_Oct2013_(web).pdf.

See Dabit, 547 U.S. at 81 (noting that increased litigation risk will "deter[] qualified individuals from serving on boards of directors").

CONCLUSION

For the reasons stated above, the Directors Forum respectfully urges the Court to grant the petition for *certiorari*.

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APPENDIX A — CURRENT FORUM MEMBERS

Aberdeen Funds

Advance Capital I Fund

AdvisorOne

Advisors Preferred Trust

AllianceBernstein Funds

AmericaFirst Quantitative Funds

American Beacon Funds

American Century Funds

AMG Funds

AQR Funds

Aquila Group of Funds

Arbitrage Funds

Artisan Partners Funds

Ashmore Funds

Aston Funds

BBH Funds Series Trust

BofA Funds

Boston Trust and Walden Funds

Calamos Fund

Calvert Group (Clusters I & II)

Capstone Funds

City National Rochdale Funds

Clearwater Investment Trust

Clipper Funds

Cohen and Steers

Columbia Acorn Funds

Columbia Atlantic Funds

Columbia Funds

Appendix A

Community Capital Trust

Conestoga Small Cap Fund

Consulting Group Capital Market Funds

CRM Funds

Delaware Funds

Deutsche Bank DBX ETF Trust

Deutsche Funds

Diamond Hill Funds

Dupree Mutual Funds

Eaton Vance

Exchange Traded Concepts

Fairholme Fund

Fidelity Investments

First American Funds

First Investors Fund

Forward Funds

Franklin Templeton Group of Funds

FundVantage

Goldman Sachs Funds

GPS Funds

Guggenheim Funds

Harding Loevner

Hartford Funds

Henderson Global Funds

Homestead Funds, Inc.

HSBC Funds

Hussman Investment Trust

Invesco

iShares Funds

Appendix A

Janus Investment Fund

John Hancock Funds

JP Morgan Funds

Lattice Strategies Trust

LMP Fixed Income Funds

MainStay Group of Funds

Managed Portfolio Series

Matthews Asia Funds

Medley Capital Corporation

Meeder Funds

Mercer Funds

MetLife Funds

Mexico Fund

MFS Funds

Miller Investment Trust

Morgan Stanley Funds

Mutual Fund Series Trust and Variable Insurance Trust

Nationwide Funds

Natixis Funds

Neuberger Berman Funds

Nomura Funds

Northeast Investors Trust

Northern Funds

Northern Lights Fund Trust (I, II, III)

NT Alpha

Nuveen Investments

Oakmark Funds

Old Westbury Funds

Oppenheimer Funds

Pacific Life Funds

PFM Funds

Appendix A

PowerShares

Praxis Mutual Funds

ProShares - ProFunds

Prudential Mutual Funds (Retail)

Prudential Mutual Funds (Variable Annuities)

Putnam Funds

RBC Funds

RidgeWorth Funds

RiverNorth Funds

RS Investments Fund

Rydex Funds

SA Funds

Sanford Bernstein Funds

Scout Funds

SEI Funds

Sentinel Funds

Sierra Income Corporation

Sterling Capital Funds

SunAmerica Annuity Funds

Tekla

Third Avenue Funds

Thrivent Mutual Funds

TIAA-CREF

TIFF Investment Program Funds

Tocqueville Trust Fund

Transamerica Asset Management Group

Tweedy Browne Funds

Two Roads Shared Trust

Vantagepoint Funds

Victory Funds

Appendix A

Voya Investment Management

Wasatch Funds

Wells Fargo Advantage Funds

Westcore Funds