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,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF PACIFIC LIFE FUND ADVISORS LLC, CAPITAL RESEARCH AND MANAGEMENT CO., ASSETMARK, INC., WELLS FARGO FUNDS MANAGEMENT, LLC, AND RUSSELL INVESTMENTS AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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INTEREST OF *AMICUS CURIAE* AND SUMMARY OF ARGUMENT[1]

Amici curiae Pacific Life Fund Advisors, LLC, Capital Research and Management Co., AssetMark, Inc., Russell Investments, and Wells Fargo Funds Management LLC, are investment advisers that offer and/or manage mutual funds that, like Petitioners' in this case, are governed by the Investment Company Act of 1940, ch. 686, 54 Stat. 789 ("ICA" or "the Act"). Combined, *amici* have trillions of dollars under management, and a nationwide pool of investors including institutional investors, financial advisors, and individuals.

Amici, their investors, and the national economy as a whole are harmed by the uncertainty and economic impact of vexatious class-action litigation. *Amici* thus share Petitioners' interest in ensuring the predictable enforcement of obligations under the ICA and in preventing "creative" plaintiffs' attorneys from inventing new causes of action as an end-run around limits that the Act places on private rights of action.

Amici are all headquartered in the Ninth Circuit—the home of more mutual fund assets under management than any other circuit—and thus *amici* could be subject to the novel and unprecedented causes of action recognized by the court below in this

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[1] Pursuant to Supreme Court Rule 37.6, *amici curiae* state that no counsel for any party authored this brief in whole or in part and that no entity or person, aside from *amici curiae*, its members, and its counsel, made any monetary contribution towards the preparation and submission of this brief. Pursuant to Supreme Court Rule 37.2(a), *amici curiae* certify that counsel of record for both petitioners and respondents received timely notice of the intent to file this brief, and have consented to this filing in letters on file with the Clerk's office.

matter unless this Court grants review of this case. Indeed (and unsurprisingly), in the wake of the Ninth Circuit's decision, class-action plaintiffs are already asserting claims for breach of contract based on mutual fund registration statements in other cases.

Amici agree that each of the questions presented is significant legally and for the national economy. On the first issue, parties should not be able to manufacture Article III standing, after filing their complaint, by purchasing assignments simply for the sake of maintaining the suit. *Amici*, however, write separately on why the second issue is worthy of review. In particular, in this brief, *amici* provide a more detailed review of the statutory scheme and legislative history of the ICA, and expand on why the Ninth Circuit's decision ignores and conflicts with this Court's conflict preemption precedent.

As explained below, the ICA establishes comprehensive, consistent national standards for investment companies. The Act requires investment companies to maintain internal controls and issue registration statements with mandated disclosures. The ICA creates a carefully balanced set of legal duties overseen by mutual fund boards of directors. At more than 90% of U.S. mutual funds, three-quarters of the directors independent of the funds' adviser, and key functions, such as approving a fund's advisory contract, selecting fund accountants, and replacing independent board members, may only be performed by independent directors. ICA §§ 15(c) 16(b), 32(a). The ICA is subject to oversight and enforcement by the U.S. Securities and Exchange Commission ("SEC"). Only a subset of the board's duties give rise to private rights of action by investors. Nothing in the ICA shows any intent that federally mandated disclosures form the basis for

state law "contracts" with investors, or provide the basis for a private right of action. In fact, the statutory history confirms the ICA's intent *not* to create a private right of action or to establish a system of inconsistent state law duties. This history confirms that the Ninth Circuit errs in finding that federally mandated disclosure can form the basis for an implied common law contract. See Pet. 30-35.

Independently, the statutory scheme and history demonstrate why creating a state common law contract claim—as a means of enforcing compliance with federally mandated disclosures—is preempted under this Court's precedents. Allowing such actions would frustrate the ICA's intent not to provide a private right of action and would open the floodgates to abusive litigation based on divergent and inconsistent state laws, again, contrary to the intent of the ICA.

ARGUMENT

I. THE IMPORTANCE OF THIS CASE TO THE U.S. MUTUAL FUND INDUSTRY WARRANTS SUPREME COURT REVIEW NOW.

Investment companies are an important and substantial part of the United States economy. The SEC estimates that at the end of 2014, it had registered 16,619 funds, with over $14 trillion in assets.[2] The Investment Company Institute

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[2] *See* SEC, Rel. No. 33-9776, *Investment Company Reporting Modernization* 9-10 (May 20, 2015), *available at* http://www.sec.gov/rules/proposed/2015/33-9776.pdf. By comparison, the U.S. Bureau of Economic Analysis estimates the entire annual U.S. gross domestic product in 2014 at just over $17 trillion. *See*

calculates that at the end of 2014, 55% of the U.S. household assets held in direct contribution retirement plans (e.g. 401(k) plans) were invested in mutual funds, as well as 48% of the U.S. household assets held in individual retirement accounts (IRAs). Investment companies hold 30% of all U.S. corporate equity securities, 26% of all U.S. municipal bonds, and 46% of U.S. commercial paper. Some 90.4 million U.S. individual investors hold mutual funds.[3]

The decision below, which creates unprecedented new causes of action against investment companies, threatens a major pillar of the U.S. financial markets. Four of the fifteen largest U.S. mutual fund families by assets under management are headquartered in the Ninth Circuit.[4] Moreover, aside from a handful of state-specific municipal bond or money-market funds, all U.S. mutual funds have shareholders in, and arguably might be subject to suit in, the Ninth Circuit under the novel theories approved below.

Undoubtedly, plaintiffs will forum shop and file suit in the Ninth Circuit to take advantage of new theories that are unlikely to succeed in other circuits. Indeed, *amici* are already aware of a case in which class action plaintiffs, in the wake of the Ninth Circuit's decision, are now asserting claims for breach

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Bureau of Econ. Analysis, *National Economic Accounts* (2015) http://www.bea.gov/national/index.htm.

[3] ICI, *2015 Investment Company Fact Book* figs.1.5, 1.6, 6.2 (55th ed. 2015), *available at* https://www.ici.org/pdf/2015_factbook.pdf.

[4] Namely, Wells Fargo Advantage Funds, American Funds, Allianz/PIMCO and Franklin Templeton. The number rises to five of the largest fifteen if one includes BlackRock/iShares, the management of which is split between California and New York. *See Mutual Fund Directory* (2015), http://mutualfunddirectory.org/ (last visited Aug. 26, 2015).

of contract based on a mutual fund registration statement.[5] The Ninth Circuit's decision to allow standing when the plaintiff did not obtain its interest until after filing its complaint—which conflicts with the decisions of other courts (see Pet. 11-24)—provides all the more reason to suspect that plaintiffs will flock to the Ninth Circuit to pursue claims. The erroneous Ninth Circuit decision recognizing contract causes of action under the varying laws of the 50 states thus will introduce uncertainty into the markets, require investment companies—wherever located—to take action to mitigate litigation risks, and will disrupt the national uniformity policy intended in the ICA. This Court should not wait for other circuits to reject the Ninth Circuit's holdings before reviewing this case.

II. THE STATUTORY SCHEME AND HISTORY OF THE ICA AND RELATED STATUTES REFUTE ANY BASIS FOR ALLOWING AN IMPLIED, STATE LAW CAUSE OF ACTION.

In this case, Plaintiffs' contract theory relies on:

- Defendant's federally required registration statement and prospectus (see ICA Sections 8, 24) as documents creating the implied-in-fact contract; and
- The requirement in ICA Section 13(a) – that mutual funds abide by their stated "fundamental polic[ies]," absent majority shareholder vote—for the existence of the allegedly breached duty.

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[5] First Am. Class Action Compl., *Hampton v. Pac. Inv. Mgmt. Co.*, No. 15-cv-00131 (C.D. Cal. filed July 6, 2015) (Dkt. No. 21) ("*Hampton v. PIMCO*").

Nothing in the ICA at its inception, its 1970 amendments or three sets of amendments in the 1990s, or in the Securities Act of 1933, or Securities Exchange Act of 1934 ("1933 Act" and "1934 Act"), suggests that the relevant provisions were intended to create any common law contractual or other private right of action. This history also demonstrates that enforcement of these provisions through class actions under disparate state laws would be contrary to the statutory scheme.

A. The ICA, As Enacted, Established Comprehensive National Standards And Does Not Create State Law Contract Rights Of Action.

1. The ICA arose out of the SEC's extensive study of the investment industry and proposals for the creation of national oversight and regulation, which investment companies themselves conceded were needed. S. Rep. No. 76-1775, at 1, 11 (1940). Much of the debate fine-tuning the ICA took place before the Senate Committee on Banking and Currency. *Id.* at 1; see generally *Investment Trusts and Investment Companies: Hearings Before the Subcomm. of the S. Comm. On Banking and Currency on S. 3580*, 76th Cong., pts 1-4, at 1 (1940) (hereinafter "1940 Senate Hearing").

The hearings and the law itself emphasized the goal of creating comprehensive national standards that, among other things, would promote uniform public disclosures, impose internal management and corporate governance controls, and ensure adequate assets and reserves. 15 U.S.C. § 80a-1(a), (b); see also, *e.g.*, *id.* § 80a-31 (establishing "uniform methods" for accounting); S. Rep. No. 76-1775, at 1, 10-11; H.R. Rep. No. 76-2639, at 5 (1940); 1940 Senate Hearing pt. 2, at 525, 538, 605, 617, 855. The hearings often

analogized to schemes in place for "national banks, interstate carriers, and other institutions subject to comprehensive Federal supervision." H.R. Rep. No. 76-2639, at 36; see also 1940 Senate Hearing pt. 1, at 132-33.

The hearings and legislative record also reflect acute concern over variation and inconsistency in state laws. Such inconsistency was undesirable because of the confusion it created, the difficulties in abiding by inconsistent requirements, and the unfairness that otherwise similarly situated investors would end up treated differently based on "some fortuitous circumstance." 1940 Senate Hearing pt. 1, at 302-03; see also, *e.g.*, *id.* pt. 2, at 930-31 (noting problem of "race" to the bottom with "48 States grinding out all the different kinds of laws on the subject of corporations, and with each one trying to outdo the other"). It runs contrary to core logic of the Act that—in creating federal disclosure requirements and operational controls—the ICA would include provisions intended to be enforceable through variable state contract law.

2. Nor do the specific provisions of the ICA at issue reflect any intent to create privately enforceable contract rights.

As pertinent here, Section 8 of the ICA governs mutual funds' SEC registration statements. From the plain statutory language, the registration statements are not a matter of private contract but of federal regulatory oversight, as the registration statement must be "in such form and containing such of the following information and documents as the Commission shall by rules and regulations prescribe as necessary." 15 U.S.C. § 80a-8(b). Moreover, the Act describes the statutorily required information as "recital[s]" of the registrant's "policy" respecting

certain activities and of those policies "which the registrant deems matters of fundamental policy and elects to treat as such." ICA § 8(b)(1), (2) (as enacted); see 15 U.S.C. § 80a-8(b)(1)-(3) (as amended). This is significant because, as a term of art, "recitals" are merely explanations of circumstances surrounding a contract and do *not* themselves create contractually binding obligations. See, *e.g.*, *Atl. Mut. Ins. Co. v. Metron Eng'g & Constr. Co.*, 83 F.3d 897, 899 (7th Cir. 1996); 17A C.J.S. *Contracts* § 403 (2015).

The other provision at issue is ICA § 13(a)(3), which prohibits registered investment companies, without majority shareholder approval, from "deviat[ing] from its policy in respect of [a] concentration of investments in any particular industry or group of industries as recited in its registration statement, or deviate from any fundamental policy recited in its registration statement." ICA § 13(a)(3) (as enacted); see 15 U.S.C. § 80a-13(a)(3). Read in context, § 13(a) is not about creating contractual voting rights in shareholders. It is about imposing corporate governance controls and operational restrictions—similar to the accounting controls, reserve requirements, and restrictions on self-dealing reflected elsewhere in the Act. Other subsections of Section 13(a) include restrictions on the ability of an investment company:

- to change its "subclassification" as an "[o]pen-end company" or "[c]lose-end company," or "from a diversified to a non-diversified company" (see ICA § 13(a)(1) (incorporating ICA § 5(a)(1));
- to "borrow money, issue senior securities, underwrite securities issues by other persons, purchase or sell real estate or commodities or make loans to other

persons," except in accordance with the recitals in its registration statement (ICA § 13(a)(2)); and

- to "change the nature of its business so as to cease to be an investment company."

The legislative history also reflects the careful balance underlying Section 13. At the hearings, David Schenker, SEC Chief Counsel for the Investment Trust Study, explained that the purpose of Section 13(a)(3), and its incorporation in the registration statement, was simply to "indicate to all persons what general type the company is going to be." 1940 Senate Hearing pt. 4, at 1115-16. Industry witnesses expressed concern over who would be able to define what constitutes a "fundamental change," and the risk that investment companies would be chilled from exercising their best managerial judgment when necessary to respond to rapid changes in the market. *Id.*, pt. 2, at 483. SEC Commissioner Healy observed that the intent was not to promote lawsuits every time a company makes a change that "some bad-tempered security holder does not like." *Id.*, pt. 2, at 934-35.

3. Ultimately, as the Ninth Circuit recognized in its prior decision, the Act struck the balance by placing primary oversight with the mutual fund's board of directors, supplemented by the discretionary enforcement power in the SEC, and not providing any private right of action to enforce Sections 8 or 13. See 15 U.S.C. § 80a-6(c), 80a-41; *Northstar Fin. Advisors, Inc. v. Schwab Invs.*, 615 F.3d 1106, 1109-11 (9th Cir. 2010). Only one provision of the ICA as originally enacted provides a private right of action: it allowed private suits for damages against closed-end fund insiders who make short-swing profits. ICA § 30(f) (now codified at 15 U.S.C. § 80a-29(h)) (incorporating

Section 16(b) of the 1934 Act); see *Northstar*, 615 F.3d at 1110-11. That Congress "knew how to create a private right of action to enforce a particular section of the Act when it wished to do so," indicates that it did not intend for private enforcement of other provisions of the Act. *Northstar*, 615 F.3d at 1117 ("Congress did not intend to create a private right of action to enforce § 13(a)."); see also *Bellikoff v. Eaton Vance Corp.,* 481 F.3d 110, 116 (2d Cir. 2007) (per curiam) (finding no private right of action for other provisions of the ICA); *Olmsted v. Pruco Life Ins. Co. of N.J.,* 283 F.3d 429, 433 (2d Cir. 2002) (same).

Moreover, the fact that the Act delegates enforcement authority over Sections 8 and 13 to the SEC runs contrary to the notion that those provisions create a private contractual right. The SEC does not merely enforce against violations of these provisions; its staff also can issue advisory letters on whether a proposed policy or investment strategy change would trigger enforcement activity.[6] To the extent contracts are a matter of *party intent*, there would be little basis for the SEC or its staff to opine. The SEC exercises its enforcement and interpretive authority based on the statutory scheme and public policy—not on its view of private contractual intent. Indeed, it would create uncertainty and frustrate the statutory scheme if investment companies, having acted in reliance on a "no action" letter, were then subject to private suits.

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[6] *See, e.g.*, SEC, No-Action Letter to BlackRock Multi-Sector Income Trust, (pub. avail. July 8, 2013), https://www.sec.gov/divisions/investment/noaction/2013/blackrock071013-17d.htm; SEC, No-Action Letter to Morgan Stanley Mortgage Securities Trust, (pub. avail. July 8, 2013), https://www.sec.gov/divisions/investment/noaction/2013/morganstanley071013-17d.htm.

B. Amendments To The ICA And Related Statutes Confirm That The Provisions Do Not Create Privately Enforceable Rights.

1. The ICA had its first major revisions in 1970. See Investment Company Amendments Act of 1970, Pub. L. No. 91-547, 84 Stat. 1413. The Senate Report confirms the original intent for uniform national standards, stating that the Act "provided a comprehensive plan of regulation" at a time "when the mutual fund industry was in its infancy." S. Rep. No. 91-184, at 5 (1969).

The 1970 amendments made clarifying changes to Section 8 and 13. The thrust was that, if a registration statement describes a policy as changeable only by shareholder vote, Section 13 applies, regardless of whether the policy is also deemed "fundamental." See Pub. L. No. 91-547, 3(c)-(d), 84 Stat. at 1415 (now codified at 15 U.S.C. §§ 80a-8(b)(3), -13(a)(3)); H.R. Rep. No. 91-1382, at 19 (1970). Those amendments also expanded the definition of "interested persons" who cannot be independent directors, in ICA § 2(a)(19).

But the 1970 amendments did not add any language creating or suggesting a private right of action to enforce Sections 8 or 13. See *Northstar*, 615 F.3d at 1118-19 (finding that 1970 amendments do not support any private right to enforce Sections 8 and 13). The 1970 amendments modified Section 36(b) to authorize a new, carefully delimited private right of action for securities holders to bring breach of fiduciary duty suits, but only for excessive management fees paid to the fund's investment adviser. Pub. L. No. 91-547, § 19, 84 Stat. at 1429 (codified at 15 U.S.C. § 80a-35(b)). Again, this amendment demonstrates that where the ICA

intends to permit investors to litigate, it expresses this explicitly.

2. In the mid-nineties, three significant amendments to the federal securities laws were enacted. First, the Private Securities Litigation Reform Act of 1995 ("PSLRA"), Pub. L. No. 104-67, 109 Stat. 737, imposes new pleading requirements and procedural rules to limit abusive private securities class action lawsuits. The PSLRA applies to all class actions under the federal securities laws, including those concerning mutual funds. The PSLRA limits who can serve as lead plaintiff, heightens the pleading requirements, prevents discovery before a complaint is found to state a claim, limits joint and several liability, and regulates abusive settlements. Allowing a common law contract cause of action based on mutual fund registration statements would evade all of these important federal law protections adopted in the PSLRA.

Next, the National Securities Markets Improvement Act of 1996 ("NSMIA"), Pub. L. No. 104-290, 110 Stat. 3416, provides a uniform national standard for securities registration and preempts state registration laws. NSMIA amends Section 18 of the 1933 Act to provide that (among other types of securities) shares of investment companies are "covered securities" exempt from state securities laws. Once again, allowing a state law contract cause of action based on mutual fund registration statements would be directly contrary to the purposes of NSMIA. The core rationale of both the PSLRA and the NSMIA is to reduce unnecessary lawsuits and state regulation that simply drove up costs and burdens for investment companies and investors.

Last is the Securities Litigation Uniform Standards Act of 1998 (SLUSA), Pub. L. No. 105-353, 112 Stat.

3227. SLUSA incorporates the definition of "covered securities," including shares of investment companies. SLUSA preempts state law class actions involving an alleged misrepresentation or omission, or use of any deceptive or manipulative device, in connection with the purchase or sale of any covered security. As Petitioner observes, SLUSA is intended to promote national standards for securities class actions and to prevent plaintiffs' attorneys from doing an end-run around the PLRSA by shifting class action lawsuits to state court. Pet. 38-40. Allowing a private plaintiff to recast an alleged misrepresentation or omission in a registration statement as an alleged breach of contract would defeat the intent of SLUSA.

At no point do any of these subsequent amendments expand or create privately enforceable rights arising from ICA Section 8 and 13. To the contrary, these amendments repeatedly manifest an intent to promote national uniformity over varying state laws, and to manage carefully the scope of private enforcement over the ICA and securities markets generally.[7]

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[7] The court below also recognized a private right of action, on a third-party beneficiary theory, based on an alleged violation of the contract between the investment company and its investment adviser. This cause of action similarly finds no support in the text or history of the ICA, and the Ninth Circuit did not claim to the contrary.

III. ALLOWING PRIVATE ENFORCEMENT OF THE ICA THROUGH VARYING STATE CONTRACT LAW IS NOT ONLY UNSUPPORTED, IT IS PREEMPTED UNDER THIS COURT'S PRECEDENTS.

For the reasons above, the statutory text, scheme, and history provide no basis to interpret the disclosures and controls required by the ICA as forming an implied-in-fact contract subject to private enforcement. Given the significance of the Ninth Circuit's ruling to securities industry and national markets, the Court should accept review and reverse on that basis alone. As discussed below, the Ninth Circuit's ruling also conflicts with this Court's preemption cases. The decision below entirely fails to deal with inherent variation among state laws that will cause a proliferation of litigation, uncertainty, and disparate treatment of investors.

A. State Contract Claims Enforcing The ICA Are Preempted.

Under the Supremacy Clause, federal law can preempt state common law, as well as statutory law, expressly or when state law stands as "'obstacle' to the accomplishment" of a significant federal objective. See *Geier v. Am. Honda Motor Co.*, 529 U.S. 861, 886 (2000); see also, *e.g.*, *Crosby v. Nat'l Foreign Trade Council*, 530 U.S. 363, 372-73 (2000); *California* v. *ARC Am. Corp.*, 490 U.S. 93, 100 (1989); *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). Statutory intent is the "'ultimate touchstone'" for determining whether a state law claim is preempted, and there is no presumption against preemption when, as here, the case involves comprehensive federal regulations and *no* longstanding coexistence of state law to enforce the federally created requirements. *Medtronic, Inc. v. Lohr,* 518 U.S. 470, 485 (1996); *Buckman Co. v.*

Plaintiffs' Legal Comm., 531 U.S. 341, 348 (2001). Two of this Court's precedents, especially, require finding preemption of state contract claims here.

First is *Buckman*, which involves state law claims challenging the marketing of a medical device, on the ground that the defendant did not comply with requirements of Food, Drug, and Cosmetics Act ("FDCA") in obtaining approval of the device. The Court explained that these claims were preempted because they "exist[ed] solely by virtue of the FDCA disclosure requirements," but the FDCA provided no private right of action. *Buckman*, 531 U.S. at 352-53. As the Court explained, rather than relying on traditional state law duties that "predated the federal enactments in questions. . . . the existence of these federal enactments is a critical element in their case." *Id.* at 353. The Court thus found allowing private parties to usurp the FDA's role and sue based on the federal requirements "would exert an extraneous pull on the scheme established by Congress, and it is therefore preempted by that scheme." *Id.*; see also *id.* at 348 (allowing state-law claims to enforce FDCA would "skew[]" the "somewhat delicate balance of statutory objectives" that the agency must preserve).

The second case is *Astra USA, Inc. v. Santa Clara County*, 131 S. Ct. 1342 (2011). *Astra* involved claims to enforce price-ceiling requirements imposed by Section 340B of the Public Health Services Act. The Court held that the Act's decision not to provide a private right of action also negated private parties' ability to bring third-party beneficiary contract claims as a matter of federal common law. *Id.* at 1345. Central to the Court's decision were the statute's intent to vest enforcement authority exclusively in the federal agency, and the fact that

the alleged contract rights were "one and the same" as the statutory obligations. *Id.* at 1348.

Although *Astra* did not itself involve preemption of state law claims, the Court cited with approval *Grochowski v. Phoenix Construction*, 318 F.3d 80, 86 (2d Cir. 2003)—a case rejecting plaintiffs' attempt to use state law contract claims to enforce prevailing wage schedules under the Davis-Bacon Act ("DBA"). The Second Circuit held that allowing such state law claims, when the federal statute itself provided no right of action, would be "an impermissible 'end run' around the DBA" and would interfere with the implementation of the statutory scheme. *Id.*[8]

The same concerns reflected in *Buckman* and *Astra* are present here. The ICA directs investment companies to be transparent about their investment policies and to observe certain management controls. The SEC, in its Form N-1A, dictates in meticulous detail exactly what investment companies must disclose in their registration statements, as well as the (typically less material) information they include in their Statements of Additional Information (SAIs), and what they must include if they prepare a

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[8] *Burks v. Lasker*, 441 U.S. 471 (1979), does not support Plaintiff's argument, BIO 27. *Burks* holds that "federal courts must be ever vigilant to insure that application of state law poses 'no significant threat to any identifiable federal policy or interest.'" 441 U.S. at 479. *Burks* holds that allowing mutual fund boards to exercise their state-law "watchdog" role over private litigation (a role the court below notably ignored) poses no such threat. But permitting a multiplicity of inconsistent state contract class actions against mutual funds poses exactly the threat *Burks* warns against.

summary prospectus.[9] The SEC regularly adjusts these disclosure requirements and indeed earlier this year proposed a revised set of mutual fund registration statement and periodic disclosures.[10] None of these SEC-mandated disclosure regulations contain any indicia of a privately negotiated contract.

At the same time, investment companies should not be chilled from adjusting their investment strategies in response to changing market conditions. Nor should investment companies be subjected to frivolous and burdensome class action lawsuits disputing the interpretation of their investment policies or fly-specking their implementation.

Indeed, *that is exactly what is occurring in this case*. The claims involve the defendant's response to changing conditions in the mortgage-backed securities market in 2006, and disputes over (a) what it means to "track" a specified index, and (b) how an "industry" should be defined for purposes of the policy that the Fund not invest more than 25% of its total assets in any one industry. Pet. App. 38a-41a. A similar dynamic appears in a recent class action copying the *Northstar* theory, where the contract claims revolve around interpretation of the policy not to invest more than 15% of assets in "securities and instruments that are economically tied to emerging market countries." First Am. Class Action Compl., *Hampton v. PIMCO*.

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[9] The instructions to the Form N-1A are more than 50 pages long, in small print. *See* SEC, Form N-1A (May 2015), https://www.sec.gov/about/forms/formn-1a.pdf.

[10] *See Investment Company Reporting Modernization*, *supra* (proposing new disclosures and discussing SEC's 1985, 2000, 2009 and 2010 mutual fund disclosure reforms).

Within the overall scheme for regulating securities, there is a role for private right of actions—as provided in Sections 11 and 12 of the 1933 Act—based on misrepresentations in a registration statement or prospectus. But such claims procedurally must satisfy the requirements of Rule 9(b) and the PSLRA, are subject to SLUSA, and the liability inquiry—which is carefully defined by the 1933 Act—focuses on whether statements were true *at the time they are made*. 15 U.S.C. § 77k(a). If a registration statement or prospectus is treated as a contract, however, traditional concepts of fraud or deceit are irrelevant; instead the registration statement and prospectus could become, in effect, a *warranty for future performance* according to whatever a trier of fact determines is the parties' "mutual intent." This expansion of liability would be particularly significant in cases involving alleged changes in policies—or alleged failures to maintain asset allocations in line with policies—due to extrinsic events or changing market conditions, exactly as occurred in the case here during the 2008 financial crisis.

Allowing such claims thus would disrupt the balance in the statute on what is subject to private enforcement—as opposed to committed to the oversight of mutual fund boards and the SEC—and would open the floodgates to litigation by "creative" class-action attorneys who could challenge any number of investment changes as allegedly violating fundamental policies. The ICA's intent to promote fulsome forward-looking disclosures about mutual funds' intended courses of action would be frustrated if the funds must fear that any changes in strategy dictated by new market conditions could result in class action state law contract lawsuits alleging

violations of the funds' registration statements, without any of the procedural protections against vexatious private litigation provided in the PSLRA or SLUSA. Indeed, plaintiffs alleging contract claims would not even have to meet the pleading requirements of Fed. R. Civ. P. 9(b), and potentially could proceed to discovery simply by alleging the registration statement as a contract, and then asserting its breach and damages. That would create exactly the problems that the PSLRA and SLUSA sought to address. *Cf. Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71 (2006) (discussing SLUSA preemption and public policy concern that "the class-action device was being used to injure "the entire U.S. economy" (internal quotation omitted)). If registration statements are treated as contracts, investment companies will have to start writing them as such—loading them with legalese and/or scaling back on their identification of fundamental policies. Such a response to the threat of lawsuits would interfere with the statutory purpose behind requiring the disclosures and the role of the SEC in determining their form and content.

This Court's precedent precludes such an end-run around ICA's carefully considered decision not to provide a private right of action for violations of Section 13. Just as *Dabit* found it "inappropriate for courts to create additional, implied exceptions" to SLUSA's express preemption provision, *id.* at 87-88, the Court should grant review to prevent courts from creating "additional, implied exceptions" to the ICA's decision not to provide a right of action to enforce federal disclosure requirements.

B. The Inherent Variation In State Contract Law Provides Further Reason For Preemption.

In addition, the Ninth Circuit's ruling would undermine the ICA's goal of national uniformity and consistency in the enforcement of the federal securities laws. That is because contract law varies substantially from state to state.

First, states have their own rules for construing and enforcing contracts, meaning that rights will vary from state to the state and their application to registration statements and prospectuses are inherently uncertain. As the present case illustrates, these cases—if pursued on contract theories—would turn on issues of "party intent" involving concepts such as what it means to "track" an index, and how investment caps should be construed. Any case could raise numerous issues as to which state law varies, such as: whether intent is a subjective or objective standard; whether one should look to extrinsic evidence, such as course of dealing or ancillary fund documents (like the SAI below, which disclosed the relevant policy change, see Pet. App. 50a); whether registration statements and prospectuses are treated as "contracts of adhesion"; and whether disclosure ambiguities should be construed against the investment company as the drafter.[11]

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[11] *See, e.g.,* 11 Richard Lord, *Williston on Contracts* § 31:1 (4th ed. 2012) ("it cannot be asserted that a single, definite standard of contract interpretation prevails"); Geoffrey Miller, *Bargains Bicoastal: New Light on Contract Theory*, 31 Cardozo L. Rev. 1475 (2010) (identifying differences between California and New York contract law in over a dozen doctrines); *compare Int'l Multifoods Corp. v. Commercial Union Ins. Co.*, 309 F.3d 76, 83 (2d Cir. 2002) (New York law does not look to extrinsic evidence of meaning absent a facial ambiguity), *with Morey v. Vannucci*,

As another example, the case below holds that, as a matter of California law, shareholders can sue an investment advisor as intended third-party beneficiaries to the agreement between the Fund Trust and the Advisor. Pet. App. 69a-76a. In so holding, it rejected defendants' authority concerning third-party beneficiary liability simply because it was "from courts outside California and this circuit," *id.* at 75a. As scholars have observed, "there is little consensus on such questions as whose intent is controlling, how that intent is to be discovered, and just how far third party standing extends."[12]

Second, allowing state "contract" claims also opens the door to state law claims for breach of the implied covenant of good faith and fair dealing. Precisely what duties are implied by this covenant may vary depending on the state law and would create overwhelming uncertainty.[13] The implied covenant could well open the door to private enforcement of *every provision of the ICA*, on the theory that investment companies have an inherent duty to abide by each provision of the ICA in carrying out the "contract" reflected in the registration statement and other disclosures.

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64 Cal. App. 4th 904, 912 (1998) (California law permits extrinsic evidence to show that otherwise unambiguous contract terms are reasonably susceptible to different meanings). New York and California are two of the three states in which the most mutual fund assets are managed.

[12] Jean Powers, *Expanded Liability and the Intent Requirement in Third Party Beneficiary Contracts*, 1993 Utah L. Rev. 67; *see also* Miller, *supra*, at 1478 (distinguishing New York's formalistic approach from California's context-based approach); 13 *Williston* § 37:29.

[13] *See* 23 *Williston* § 63.22 (describing the wide variation in requirements across jurisdictions for proving a breach of the covenant of good faith and fair dealing).

Third, the statute of limitations governing written contracts varies dramatically, from as long as ten years in some states to as little as three years in others.[14]

Fourth, there are any number of other, state-specific rules and nuances that would generate complexity, uncertainty, and legal wrangling in a given case. For example, the Ninth Circuit simply assumes that Massachusetts law would apply to a fund organized as a Massachusetts Trust. But it did not conduct any actual choice-of-law analysis, and different states use different tests to determine which state's law applies to a contract or whether a choice-of-law provision is enforceable.[15] States also have different rules regarding, for example, the measure of contract damages, and doctrines for reforming contractual terms based on unilateral mistake.[16]

Allowing state law contract claims would create inconsistent rights and obligations for otherwise similarly situated funds and investors, based simply on which state's law applies. The scope of investment

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[14] *Compare* La. Civ. Code Ann. art. 3499 (ten year statute of limitations), *with* Del. Code Ann. tit. 10, § 8106 (three year statute of limitations); *see also* 31 *Williston* § 79:3 ("Thus, it follows that a right of action may be barred in one jurisdiction but not in another.").

[15] *See* 8 *Williston* §§ 19:4, 19:6 (describing different views for determining governing law absent a choice-of-law provisions, and differing tests on enforceability of contractual choice-of-law clauses).

[16] *See* 24 *Williston* § 64:2 (describing different state tests for damages); *id.* § 70:104; *see also* 77 Am. Jur. Proof of Facts 3d 169 (2015) (discussing various cases where reformation was granted despite unilateral mistake); *see also* Miller, *supra*, at 1504 (reformation based on unilateral mistake is more readily available in California than New York).

companies' rights and duties would be inherently unpredictable with any given case raising procedural and interpretive issues that could only be resolved through expensive and burdensome litigation. As explained above, the very reason for enacting the ICA in 1940 was to create federal uniformity and to replace exactly this inconsistency among state laws governing mutual funds that had existed until then.

* * *

Because of the significance of the Ninth Circuit's ruling to the national economy and securities markets, and because that decision misconstrues the ICA, ignores this Court's conflict preemption precedents, and reintroduces the inconsistencies of state contract law that the ICA is intended to remove, review by this Court is warranted.

CONCLUSION

For these reasons, and those stated by petitioners, the writ should issue and the decision of the Ninth Circuit should be reversed.

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