No. 15-134

IN THE

Supreme Court of the United States

SCHWAB INVESTMENTS, ET AL.,
Petitioners,

v.

NORTHSTAR FINANCIAL ADVISORS, INC., ET AL.,
Respondents.

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

BRIEF OF *AMICI CURIAE* INVESTMENT COMPANY INSTITUTE AND INDEPENDENT DIRECTORS COUNCIL IN SUPPORT OF PETITIONERS

PAUL SCHOTT STEVENS
DAVID W. BLASS
DOROTHY M. DONOHUE
INVESTMENT COMPANY INSTITUTE
1401 H Street, N.W.
Washington, DC 20005

AMY B.R. LANCELLOTTA
ANNETTE M. CAPRETTA
INDEPENDENT DIRECTORS COUNCIL
1401 H Street, N.W.
Washington, DC 20005

MICHAEL K. ISENMAN
WILLIAM M. JAY
Counsel of Record
ANDREW KIM
GOODWIN PROCTER LLP
901 New York Ave., N.W.
Washington, DC 20001
wjay@goodwinprocter.com
(202) 346-4000

August 28, 2015

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES..................................... iii

INTEREST OF THE *AMICI CURIAE* 1

SUMMARY OF ARGUMENT..................................... 3

ARGUMENT 4

A. Certiorari Is Warranted Now Because Of The Immediate And Far-Reaching Threat To Mutual Funds And Their Investors. 5

B. Transforming A Federally-Mandated Disclosure Document Into A Privately Enforceable Contract Conflicts With The Comprehensive Regulatory Framework Governing Mutual Funds. 8

1. Federal Law Dictates The Content, Form, And Organization Of A Mutual Fund Prospectus.......................... 9

2. The Ninth Circuit's Decision Threatens To Transform Every Mutual Fund Prospectus Into An Enforceable Contract. 12

3. Creating A State Law Cause Of Action Premised On Prospectus Disclosure Improperly Circumvents The Federal Regulatory Framework For Mutual Funds. 16

CONCLUSION 21

TABLE OF AUTHORITIES

CASES: **Page**

Alexander v. *Sandoval*,
532 U.S. 275 (2001) 20

Astra USA, Inc. v. *Santa Clara County*,
131 S. Ct. 1342 (2011) 20, 21

Blue Chip Stamps v. *Manor Drug Stores*,
421 U.S. 723 (1975) 8

Cigna Corp. v. *Amara*,
131 S. Ct. 1866 (2011) 13

Cort v. *Ash*,
422 U.S. 66 (1975) 19

Daily Income Fund, Inc. v. *Fox*,
464 U.S. 523 (1984) 20

Erie R.R. v. *Tompkins*,
304 U.S. 64 (1938) 17

Gustafson v. *Alloyd Co.*,
513 U.S. 561 (1995) 19

Omnicare, Inc. v. *Laborers Dist. Council Constr. Indus. Pension Fund*,
135 S. Ct. 1318 (2015) 18

Tr. of Dartmouth College v. *Woodward*,
17 U.S. 518 (1819) 17

STATUTES:

SECURITIES ACT OF 1933, 15 U.S.C. § 77A *et seq.*

15 U.S.C. § 77e(b)(2) 10

15 U.S.C. § 77f.......... 18

15 U.S.C. § 77j(a)(3) 14

15 U.S.C. § 77k(a)(1) 18

15 U.S.C. § 77k(a)(2) 18

15 U.S.C. § 77*l*(a)(2) 18

15 U.S.C. § 77r 17

SECURITIES EXCHANGE ACT OF 1934,
15 U.S.C. § 78a *et seq.*

15 U.S.C. § 78j(b) 18

INVESTMENT COMPANY ACT of 1940,
15 U.S.C. § 80a-1 *et seq.*

15 U.S.C. § 80a-2(a)(32) 19

15 U.S.C. § 80a-5(a)(1) 19

15 U.S.C. § 80a-8(b) 9

15 U.S.C. § 80a-13.......... 20

15 U.S.C. § 80a-41(a) 19

Investment Company Amendments Act of 1970, Pub. L. No. 91-547, 84 Stat. 1413 (1970) 20

National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (1996) 16, 17

Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (1998) 17

REGULATIONS:

17 C.F.R. § 230.421(b) 11

17 C.F.R. § 230.485(a) 14

17 C.F.R. § 230.485(b) 14

17 C.F.R. § 230.498 10

17 C.F.R. § 240.10b-5 19

17 C.F.R. Part 270 16

17 C.F.R. § 270.22c-1 19

17 C.F.R. § 274.11A 9

Securities and Exchange Commission Form N-1A, *available at* http://www.sec.gov/about/forms/formn-1a.pdf 10, 11, 12, 14

OTHER AUTHORITIES:

Investment Company Institute, 2015 Investment Company Fact Book: A Review of Trends and Activities in the U.S. Investment Company Industry, *available at* https://www.ici.org/pdf/2015_factbook.pdf 6

INTEREST OF THE *AMICI CURIAE*[1]

The Investment Company Institute ("ICI") is the national association of registered investment companies in the United States. ICI's members include open-end investment companies (the most common kind of investment company, which includes both mutual funds and most exchange-traded funds ("ETFs")), closed-end investment companies, and unit investment trusts. ICI's members collectively account for 97% of the approximately $18 trillion in U.S. mutual fund and other registered investment company assets.

ICI has three core missions: encouraging adherence to high ethical standards by all industry participants; promoting public understanding of funds; and advancing the interests of funds and their shareholders, directors, and investment advisers. As part of these missions, ICI pursues an extensive research program and is the primary source of aggregate industry data relied on by government regulators, industry participants, and independent observers.

The Independent Directors Council ("IDC"), part of ICI, aims to advance the education, commun-ication, and policy positions of fund independent directors and promote public understanding of their

---

[1] All parties received timely notification of amici's intent to file this brief, and all parties have consented to its filing. No counsel for a party authored any part of this brief, and no such counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than *amici curiae* or their counsel made a monetary contribution to the brief's preparation or submission.

role. IDC supports fund independent directors in fulfilling their responsibilities to advance the interests of fund shareholders. It seeks to promote the highest standards of fund governance for the benefit and protection of fund shareholders. It keeps fund directors informed about issues that affect their ability to fulfill their responsibilities while adapting to the rapidly changing financial services landscape. IDC provides the perspective of fund independent directors on policy matters. IDC's activities are led by a Governing Council of independent directors from among the nearly 2,000 directors who sit on boards of ICI member funds.

ICI and IDC work toward the efficient and effective operation of the federal regulatory scheme that protects mutual fund shareholders. Mutual funds are comprehensively regulated and offer investors a high level of protection. Funds, their investors, and their advisers all have benefited from the strong regulatory scheme set forth in the Investment Company Act of 1940 ("ICA"), the Investment Advisers Act of 1940 ("Advisers Act"), the Securities Act of 1933 ("Securities Act"), and the Securities Exchange Act of 1934 ("Exchange Act"), and the implementing regulations the Securities and Exchange Commission ("SEC") has promulgated thereunder. IDC and ICI and their members have a strong interest in ensuring that this regulatory framework, as intended by Congress, continues to serve mutual funds and their investors effectively.

Their respective constituents, missions, and expertise make ICI and IDC well-suited to assist the Court in understanding the importance of the issues

raised by the petition for certiorari and the extraordinarily broad impact that the Ninth Circuit's decision threatens to have on mutual funds and their shareholders.

SUMMARY OF ARGUMENT

The Ninth Circuit's decision raises issues of national importance that warrant this Court's review without delay. Every mutual fund now faces the prospect of breach of contract lawsuits alleging misstatements and omissions in mutual fund prospectuses. That new and erroneous form of liability will have an immediate effect on a key sector of the American economy unless this Court steps in quickly. More than 90 million Americans collectively invest almost $16 trillion in mutual funds for savings and retirement. As a result of the Ninth Circuit's decision, those mutual funds—and their shareholders—now risk the expense and distraction of lengthy litigation sounding in the contract law of potentially any state. That immediate and widespread threat justifies granting certiorari.

The Ninth Circuit's new cause of action impedes the comprehensive federal regulatory scheme that governs mutual funds. In contrast to a contract, a mutual fund prospectus is a disclosure document required by the federal securities laws. A detailed SEC regulation dictates a mutual fund prospectus's content, form, and organization. In particular, SEC regulation requires that prospectuses provide investors with the essential information to decide whether to purchase fund shares while omitting information not useful to the typical investor.

The Ninth Circuit's decision threatens to convert every prospectus into a contract enforceable under common law. Federal law requires that all mutual fund prospectuses include the kind of disclosure the Ninth Circuit interpreted as creating a contractual relationship. That means that under the Ninth Circuit's reasoning, every shareholder could enforce his or her prospectus under a breach of contract theory. Moreover, because federal law requires that mutual funds update their prospectuses regularly, mutual funds face the prospect of a multitude of contract claims based on different prospectuses.

Congress intended that regulation of mutual funds occur at the national, not state, level. Congress has regulated mutual funds comprehensively, explicitly preempted state regulation of mutual fund prospectuses, and provided express private rights of action to address misstatements and omissions in mutual fund prospectuses. Creating a new cause of action to enforce prospectus disclosure that would vary by state violates Congress's intent and is unjustified in light of existing federal remedies.

ARGUMENT

The Ninth Circuit's decision creates a new basis for liability for misstatements or omissions in a prospectus. Consequently, a shareholder who believes the mutual fund has deviated from an investment policy disclosed in the prospectus may not only look to a Congressionally-created cause of action under the federal securities laws, but may also bring an action for breach of contract under state law. Under the theory the Ninth Circuit has

endorsed, crucial matters of mutual fund management apparently now can be subject to litigation under the ill-fitting 50-state patchwork quilt of contract law. This new cause of action, which threatens a profound disruption of the mutual fund industry, is premised on a fundamental misunderstanding of the role of mutual fund disclosure under the federal securities laws. The Court should step in swiftly to undo the damage before it compounds.

Although this brief focuses on the second question presented in the petition, which pertains to the merits of the Ninth Circuit's decision, the first question presented, on which the circuits have split, clearly warrants the Court's review as well. Indeed, granting review and reversing on the first question would have the ancillary benefit of erasing the perverse circuit precedent discussed in this brief.

A. Certiorari Is Warranted Now Because Of The Immediate And Far-Reaching Threat To Mutual Funds And Their Investors.

For the first time in the seventy-five year history of the modern mutual fund industry, every mutual fund in America now must operate on the assumption, following the Ninth Circuit's decision, that its investors may enforce a prospectus's terms through an action for breach of contract under the laws of any state. It is an unjustified and unprecedented expansion of potential grounds for litigation against mutual funds, with significant adverse consequences for funds and shareholders, including significant new costs and compliance burdens. This Court accordingly should grant review

on the second question presented by the petition. If it does not, the issue may not return to this Court until it is too late to relieve mutual funds of the burden the Ninth Circuit has created. This Court should reverse the Ninth Circuit's decision *before* those millions of Americans pay the "litigation tax" that this decision threatens.

Such a profound risk to mutual funds and their shareholders presents an issue of nationwide importance. Mutual funds are the primary vehicle for investing and retirement savings in the United States. Either directly or through their 401(k), IRA, and other retirement accounts, over 90 million individuals, and over 53 million households—more than 43% of all American households—own mutual funds. Investment Company Institute, 2015 Investment Company Fact Book: A Review of Trends and Activities in the U.S. Investment Company Industry 33, 114, *available at* https://www.ici.org/pdf/2015_factbook.pdf. More than two-thirds of households earning at least $50,000, and more than one-third of households earning between $35,000 and $50,000, own mutual funds. *Id.* at 118. Collectively, Americans invest nearly $16 trillion in almost 8,000 mutual funds. *Id.* at 29, 177.

Under the Ninth Circuit's theory, every one of those mutual funds risks an unending barrage of suits under disparate state law. That theory turns on mistaken interpretation of rules that apply to, and attributes that are true of, *every* mutual fund. As discussed below, federal law requires *all* mutual funds to provide prospectuses to their shareholders; requires those prospectuses to include certain

disclosure, like those at issue here; and already provides both private and governmental enforcement mechanisms for misstatements and omissions in the prospectus.

Thus, the Ninth Circuit's decision threatens every mutual fund with common law causes of action premised on prospectus disclosure, separate from the statutory causes of action Congress already authorized. A mutual fund shareholder seeking to litigate whether an investment decision is consistent with prospectus disclosure apparently can look to contract law in addition to or instead of federal securities law.[2] And even if none of those lawsuits ever recovers a penny, the nature of breach-of-contract claims means that each one will be costly to litigate. Because the Ninth Circuit specifically refused "to characterize the contract here as either express or implied," Pet. App. 38a, plaintiffs could seek to prove the scope of the "contract" through extrinsic evidence about the subjective understanding of the parties, making these cases difficult to resolve on motions to dismiss—and perhaps even on summary judgment, if the cases turn into a battle of dueling affidavits. Cases that would otherwise be resolved at the pleadings stage may now proceed to lengthy and costly discovery and

---

[2] New claims premised on the Ninth Circuit's decision already are being filed. See, *e.g.*, First Am. Compl., *Hampton* v. *Pacific Inv. Mgmt. Co. LLC*, No. 8:15-cv-00131, ECF No. 21 (C.D. Cal. filed July 6, 2015) [hereinafter "PIMCO Complaint"] (asserting new claim for breach of contract against mutual fund for alleged failure to comply with "principal investment strategies" disclosed in the prospectus).

potentially to trial. As the Court explained in the context of 10b-5 fraud actions, "in the field of federal securities laws governing disclosure of information even a complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial so long as he may prevent the suit from being resolved against him by dismissal or summary judgment." *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 740 (1975).

Mutual funds, and thus their shareholders, directly or indirectly will bear these litigation costs. Shareholders will not avoid paying these costs just because their particular mutual funds have not yet been sued. Even setting aside the obvious direct costs to funds actually named in new litigation, increased litigation costs ultimately will affect insurance, compliance, and operating costs for *all* funds.

Mutual funds and their millions of shareholders will experience the threat of these value-destroying effects immediately, unless the Court steps in to correct the error.

B. Transforming A Federally-Mandated Disclosure Document Into A Privately Enforceable Contract Conflicts With The Comprehensive Regulatory Framework Governing Mutual Funds.

By allowing a shareholder to enforce a mutual fund prospectus's terms through a claim for breach of contract, the Ninth Circuit has up-ended the carefully crafted federal framework regulating mutual funds. Under that federal framework, all

mutual funds must provide their shareholders with a prospectus. Federal regulation dictates the content, form, and organization of that prospectus, which must be filed with the SEC. In effect, the Ninth Circuit has created a new private right of action to enforce prospectus disclosure that is separate from the private rights of action that Congress expressly created. In so doing, the Ninth Circuit violates Congress' intent that mutual fund prospectuses be regulated only at the federal level and substitutes its judgment about private rights of action for that of Congress.

1. Federal Law Dictates The Content, Form, And Organization Of A Mutual Fund Prospectus.

Under federal law, a mutual fund prospectus bears no resemblance to a freely negotiated agreement between contracting parties. Fund prospectuses are mandatory disclosure documents, and mutual funds do not choose whether to file them with the SEC or in many respects what content to include. Nor do investors have any input into their content. Rather, federal statute and SEC regulations dictate what appears in a mutual fund prospectus. See 15 U.S.C. § 80a-8(b). The SEC has promulgated Form N-1A, the form that mutual funds use to register under the ICA, register their shares under the Securities Act, and file subsequent amendments to their registration statements. See 17 C.F.R. § 274.11A. Over 50 pages long, Form N-1A sets forth strict, detailed, and lengthy requirements for the organization and content of a mutual fund prospectus and all other parts of the fund's

registration statement. See Form N-1A, *available at* http://www.sec.gov/about/forms/formn-1a.pdf.

As promulgated by the SEC, "[t]he purpose of the prospectus is to provide essential information about the Fund in a way that will help investors to make informed decisions about whether to purchase the Fund's shares described in the prospectus." Form N-1A, General Instructions C(2)(a). A purchaser of shares in a mutual fund must receive a copy of the current prospectus (either the "statutory prospectus" or a "summary prospectus") no later than on confirmation of the purchase. 15 U.S.C. § 77e(b)(2); 17 C.F.R. § 230.498.

Form N-1A requires that a prospectus include, among other things:

- the fund's investment objective;
- a fee table and expense example, each of which must follow a specified form;
- the fund's principal investment strategies and principal risks, both in summary and more detailed forms;
- the fund's principal investment policies;
- a chart and a table reflecting the fund's annual returns and a comparison to a benchmark;
- information about the fund's investment adviser; and
- financial information about the fund.

Form N-1A, Items 2-5, 9, 13.

Form N-1A dictates not only the content, but the order and form in which it must appear. Even though SEC regulations allow most other public companies to vary the organization of their prospectuses, see 17 C.F.R. § 230.421(b), Form N-1A requires a mutual fund to have most prospectus disclosure appear in a specified order without variation. Form N-1A, General Instructions C(3)(a).

Federal law treats what must *not* appear just as carefully as what *must* appear. In particular, "[t]he prospectus should avoid[] including lengthy legal and technical discussions" and "[a]void excessive detail, technical or legal terminology, and complex language." Form N-1A, General Instructions C(1)(c). More generally, Form N-1A instructs that the registration statement, including the prospectus, "should be as simple and direct as reasonably possible and should include only as much information as is necessary to enable an average or typical investor to understand the particular characteristics of the Fund." *Id.* Information that the SEC "has concluded is not necessary or appropriate in the public interest or for the protection of investors to be in the prospectus, but that some investors may find useful" should not appear in the prospectus, but rather in the "statement of additional information" or "SAI," whose requirements are set forth in Part B of Form N-1A. Form N-1A, General Instructions C(2)(b); see *id.*, Items 14-27.

2. The Ninth Circuit's Decision Threatens To Transform Every Mutual Fund Prospectus Into An Enforceable Contract.

According to the Ninth Circuit, it was disclosure of the mutual fund's "fundamental investment objectives in the registration statement and prospectuses" that created a contractual offer, which the court thought investors then accepted when they purchased shares. Pet. App. 37a. But no fund has a choice in the matter. It is Form N-1A that requires a mutual fund's "investment objectives" and "principal investment strategies" to appear in the prospectus. Form N-1A, Items 2, 4, 9. Disclosure of which investment policies are "fundamental"—i.e., that "may not be changed without shareholder approval"—typically appears not in the prospectus but rather in the SAI. Form N-1A, Item 16(c)(1)(vii).

Since every mutual fund prospectus must disclose investment objectives like the ones the Ninth Circuit relied on here, it follows that, under the Ninth Circuit's reasoning, every mutual fund prospectus would give rise to a private enforcement right under contract law. Indeed, the Ninth Circuit's decision does not purport to limit breach of contract actions to investment objectives or policies disclosed in the prospectus. Rather, under the Ninth Circuit's reasoning, virtually any misstatement or omission in the prospectus could give rise to a breach of contract action. Yet many features of the federally mandated prospectus make treating it and enforcing it as a contract singularly inappropriate.

Most significantly, federal requirements—not the supposed "contracting parties"—specify the

prospectus's content. Parties are ordinarily free to draft a contract to reflect their agreement, but mutual funds are *not* free to draft a prospectus however they wish. As explained above, federal law and regulations specify what content a prospectus should contain, to provide essential information in a simple manner. The highly structured nature of the disclosure that a prospectus provides, heavily influenced by the SEC's focus on keeping mutual fund prospectuses clear, concise, and investor-friendly, strongly rebuts the notion that the prospectus is meant to set out contractual obligations. Cf. *Cigna Corp.* v. *Amara*, 131 S. Ct. 1866, 1877-78 (2011) (basic objective of an ERISA summary plan description is "clear, simple communication," making it unlikely that Congress intended it to be "legally binding," because that "could well lead plan administrators to sacrifice simplicity and comprehensibility in order to describe plan terms in the language of lawyers").

The Ninth Circuit's own decision demonstrates some of the problems that arise by transforming a mutual fund prospectus into an enforceable contract. The appellate court rejected the argument that disclosure that appeared in the SAI was sufficient notice to cure any claimed breach of contract premised on prospectus disclosure. Noting that "[t]he SAI is not automatically provided investors" but instead must be "request[ed]," the Ninth Circuit held that it was "reasonable to assume that ... many ordinary shareholders ... do not" "make the effort to ask for an SAI." Pet. App. 52a-53a. According to the Ninth Circuit, disclosure in the SAI did not provide "shareholders with clear and unambiguous notice."

However, it is SEC regulation—Form N-1A—that instructs that this disclosure appear in the SAI rather than the prospectus. See Form N-1A, Item 16(c) (requiring disclosure of fundamental policies and whether the fund "reserves freedom of action with respect to any practice" to appear in the SAI).

If the Ninth Circuit's decision is allowed to stand, a fund thus faces a Hobson's choice: It can try to satisfy the letter and spirit of the SEC's disclosure requirements by drafting a clear, concise, and investor-friendly prospectus, and in the process expose itself more broadly to contractual liability. Or it can try to insulate itself from contractual liability by including extensive, technical, and legalistic prospectus disclaimers and disclosures that risk violating federal requirements and that leave investors with a convoluted and less understandable document on which to base their investment decisions.

The absurdity of converting a mutual fund prospectus into a contract becomes even worse as the prospectus changes over time. Unlike a contract, or for that matter most prospectuses used outside of the mutual fund context for a company's initial public offering, federal law and SEC regulations require that a mutual fund prospectus not remain static. Unlike a typical public company, a mutual fund offers its shares continuously, and therefore must update its prospectus regularly—at least annually and more often if there is a material change. See 15 U.S.C. § 77j(a)(3) (requiring updated information in prospectuses); 17 C.F.R. § 230.485(a), (b) (regulations governing the updating of mutual fund registration

statements). Current disclosure about a fund (including its investment objectives and policies, which over time may change) thus appears not in the prospectus previously in effect when the shareholder purchased the shares, but rather in the currently operative prospectus, which the shareholder generally receives at least annually.

The Ninth Circuit's decision would create continuing liability and exposure for stale prospectuses long after they ceased to be in effect. Although not entirely clear, the Ninth Circuit's decision appears to hold that the operative contract is the prospectus in effect when shares are purchased. Pet. App. 49a ("The Fund offered the shareholders the right to invest on these terms, and the shareholders accepted by so investing."). This would mean, in effect, that each prospectus would create a separate enforceable contract for the subset of shareholders who purchased shares while that particular prospectus was in effect. A fund would have an unmanageable number of different contracts in force simultaneously. And shareholders who (as is typical) bought shares of the same fund at different times (for example, by automatically reinvesting their dividends and capital gains) would have numerous, serial contracts with the fund, each containing somewhat different terms and applicable to different lots of fund shares.

3. Creating A State Law Cause Of Action Premised On Prospectus Disclosure Improperly Circumvents The Federal Regulatory Framework For Mutual Funds.

Funds operate nationally and should not face variable state law liability as a consequence of complying with federal requirements. The Ninth Circuit's endorsement of a breach-of-contract cause of action is especially suspect because Congress has prohibited state regulation of mutual fund prospectuses and registration statements and has provided express private rights of action to address misstatements or omissions in these documents. Creating an additional state-law enforcement mechanism premised on mutual fund prospectus disclosure is not just unnecessary; it affirmatively interferes with the federal regulatory scheme.

Mutual funds and their advisers are subject to regulation under four interlocking federal statutes: the ICA, the Advisers Act, the Securities Act, and the Exchange Act. The SEC has promulgated comprehensive regulations that govern mutual funds. See, *e.g.,* 17 C.F.R. Part 270 (rules and regulations promulgated under the ICA).

Congress has amended federal law regulating mutual funds to make clear that mutual funds should be subject to uniform national regulation rather than separate regulation by the states. Congress enacted the National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (1996) ("NSMIA"), to preempt state regulation of mutual funds (and most other

nationally traded securities).[3] Among other things, NSMIA amended the Securities Act to preclude state law, regulation, or administrative action that "directly or indirectly prohibit, limit, or impose any conditions upon" various documents, including mutual fund prospectuses. See NSMIA § 102 (amending 15 U.S.C. § 77r).

Imposing breach of contract liability under state law for misstatements and omissions in mutual fund prospectuses frustrates this uniformity goal. By permitting a shareholder to enforce prospectus disclosure under state law, the Ninth Circuit effectively created not one new right of action, but rather one for each state. (Despite the Ninth Circuit's references to *Trustees of Dartmouth College* v. *Woodward*, 17 U.S. 518 (1819), see Pet. App. 38a-40a, there is no uniform general federal common law of implied contracts. See *Erie R.R.* v. *Tompkins*, 304 U.S. 64 (1938).)

Differences in state contract law mean that the same disclosure could give rise to an enforceable right in some states but not others. Statutes of limitation for breach of contract vary by state, meaning that depending on the passage of time a breach of contract action may be extinguished in some states but not others. Moreover, the treatment of implied contractual duties and covenants varies among the states. As a result, whether an investor

---

[3] Similarly, Congress enacted the Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (1998), to restrict most securities fraud class actions involving mutual funds and other nationally traded securities to federal court.

could bring an action for breach of contract based on prospectus disclosure could depend on which state's law applied.

Nor is any new private enforcement mechanism based on breach of contract necessary to ensure prospectus accuracy. Congress has expressly created private rights of action for mutual fund investors in the event of misstatement or omission either in the prospectus or elsewhere in the registration statement.

Under federal law, a mutual fund's registration statement must be signed by (a) the fund itself, (b) its "principal executive officer," (c) its "principal financial officer" and "principal accounting officer," and (d) by a "majority of its board of directors." 15 U.S.C. § 77f. Under Section 11 of the Securities Act, each of these signatories, and all members of the board regardless of whether they sign the registration statement, face liability for any "untrue statement of a material fact" or material omission in that registration statement, including the prospectus. 15 U.S.C. § 77k(a)(1), (2). Likewise, under Section 12 of the Securities Act, a fund's underwriter is liable for any material misstatement or omission in a fund's prospectus. 15 U.S.C. § 77*l*(a)(2). Moreover, investors may bring an action for fraud in connection with the purchase or sale of fund shares under Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and 17 C.F.R. § 240.10b-5. Shareholders make frequent use of these statutory causes of action. See, *e.g.*, *Omnicare, Inc.* v. *Laborers Dist. Council Constr. Indus. Pension Fund*, 135 S. Ct.

1318 (2015) (Section 11); *Gustafson* v. *Alloyd Co.*, 513 U.S. 561 (1995) (Section 12).

In addition, apart from these federal causes of action, shareholders have the ultimate power to "vote with their feet" if they are dissatisfied with their fund investment in any way. Shareholders have daily redemption rights, which permits them to divest themselves of their shares on any business day. See 15 U.S.C. § 80a-2(a)(32) (defining "redeemable security"); 15 U.S.C. § 80a-5(a)(1) (defining "open-end company"—that is, a mutual fund—to mean a "management company" that sells "or has outstanding any redeemable security"); 17 C.F.R. § 270.22c-1 (requiring redemption to occur at a price equal to the next computed net asset value).

Moreover, the SEC has express statutory authority to enforce the securities laws and regulations governing mutual funds. See, *e.g.*, 15 U.S.C. § 80a-41(a). The SEC makes regular use of these enforcement powers.

The Court has made clear that judicial attempts to imply a cause of action to enforce a federal statute are disfavored absent a clear legislative intent to create a private remedy. *Cort* v. *Ash*, 422 U.S. 66, 78–79 & n.8 (1975). The extensive set of remedies here, including both private and governmental causes of action, strongly counsels against judicially inferring new ones that do not appear in the statute. As the Court has explained, "[t]he express provision of one method of enforcing a substantive rule suggests that Congress intended to preclude others."

Alexander v. *Sandoval*, 532 U.S. 275, 290 (2001).[4] Moreover, when Congress wants to create a new private right of action under the ICA, it knows how to do so. For example, in 1970 Congress amended Section 36 of the ICA to create a new private right of action if an investment adviser charges a fund excessive fees. See Investment Company Amendments Act of 1970, Pub. L. No. 91-547, § 20, 84 Stat. 1413 (1970) (codified at 15 U.S.C. § 80a-35(b)). See generally *Daily Income Fund, Inc.* v. *Fox*, 464 U.S. 523 (1984).

The existing express statutory enforcement mechanisms for misstatements and omissions in the registration statement and prospectus and for fraud in connection with purchase and sale of fund shares reflect Congress' intent; state law-based contractual claims do not. It is no answer to say that contract law exists independently of federal law and that the federal law does not explicitly refer to state contract law. Contract law cannot be used to circumvent federal limitations on private rights of action. See *Astra USA, Inc.* v. *Santa Clara County*, 131 S. Ct. 1342, 1347-49 (2011). "The absence of a private right to enforce the statutory . . . obligations would be rendered meaningless if [plaintiffs] could overcome that obstacle by suing to enforce the [prospectus as a

---

[4] In fact, the respondent here sought a private remedy for an alleged breach of Section 13 of the ICA, 15 U.S.C. § 80a-13, and both the district court and the Ninth Circuit declined to create that new cause of action. That prompted the respondent instead to re-plead its claim as breach of contract premised on the prospectus disclosure. Pet. App. 33a-34a.

contract] instead." *Id.* at 1348. Here as in *Astra*, the "obligations, in short, are one and the same." *Id.*

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

PAUL SCHOTT STEVENS
DAVID W. BLASS
DOROTHY M. DONOHUE
INVESTMENT COMPANY INSTITUTE
1401 H Street, N.W.
Washington, DC 20005

AMY B.R. LANCELLOTTA
ANNETTE M. CAPRETTA
INDEPENDENT DIRECTORS COUNCIL
1401 H Street, N.W.
Washington, DC 20005

MICHAEL K. ISENMAN
WILLIAM M. JAY
Counsel of Record
ANDREW KIM*
GOODWIN PROCTER LLP
901 New York Ave., N.W.
Washington, DC 20001
wjay@goodwinprocter.com
(202) 346-2000

August 28, 2015

* Admitted only in California. Application to the D.C. Bar is pending; practice supervised by William M. Jay.