

2. Enforcement of breaches of duty

Section 36 of the 1940 Act authorizes the SEC to proceed against certain persons for "gross misconduct or gross abuse of trust" towards an investment company. This provision has been ineffective. For one thing, the very terms themselves exclude most situations involving ordinary breaches of duty or conflict of interests. The adjective "gross" connotes something much more serious, perhaps bordering on the criminal. Secondly, when the SEC has used this provision to challenge certain types of duty breach, it has been unsuccessful precisely because the activity complained of lacked the degree of turpitude suggested by the language of Section 36. See *SEC v. Insurance Securities, Inc.*, 254 R.2d 642 (9th Cir. 1958). Compare *Aldred Inv. Trust v. SEC*, 151 F.2d 254 (1st Cir. 1945). Finally, the SEC has been reluctant to use this section to stigmatize conduct, which may well be questionable, with the pejorative terms "gross misconduct or gross abuse of trust," apart from the fact that the conduct may not itself be so "gross" as all that.

Because the present Act lacks any general provision for the SEC to challenge breaches of duty—and, indeed, the very presence of Section 36 may be interpreted adversely to implying other and wider enforcement powers in the statute—most of the important litigation has been instituted by private parties in state courts. This is most obviously true of the cases attacking the advisory fee; and, as indicated earlier, the courts unfortunately invoked state law restrictions which proved to be inappropriate to the difficult and subtle problems in the litigation, although outstanding judges, such as Chancellor Seitz in Delaware, recognized the anomaly.

Quite clearly, the statute should give the SEC standing to invoke court aid in situations not now encompassed by the narrow terms "gross misconduct or gross abuse of trust." Section 20 of the Investment Company amendments would permit an action if certain persons have or will engage "in any act or practice constituting a breach of fiduciary duty" to the fund. This includes the offenses covered by existing language, but the merit of the proposed revision is that it will permit challenge of many other types of duty breach or interest conflicts. Both in the existing law and under the proposed language, the same persons will be covered: officers, directors, investment advisors, depositors, and principal underwriters.

3. SEC intervention in certain private actions under the Investment Company Act of 1940

Section 23 of the Investment Company Amendments of 1967 would amend Section 44 of the 1940 Act by adding new provisions authorizing the SEC to intervene as a party in any action growing out of two of the major new substantive provisions which have been proposed. The first would permit SEC participation in any action seeking to enforce the standard of reasonableness (new Section 15(d)) which would govern the compensation charged to a fund by its investment advisor or principal underwriter. See discussion of this substantive provision, *supra* at pages 801-804. The second would authorize SEC intervention in private actions enforcing the prohibition in new Section 15(g) against certain transfers of the assets or securities of an investment advisor in the change of control occasioned by such transfers would "likely * * * impose additional burdens on the investment company or limit its freedom of future action or otherwise is inequitable to such investment company."

I believe that it would be desirable to authorize SEC participation in both classes of suits when instituted by private parties. Both proposals involved new, and in some respect novel, statutory provisions. I believe that SEC expertise on these topics would be of material aid to courts in developing a sound body of case law, since the SEC could thus bring to bear its accumulation of data and information demonstrating the need for enactment of these substantive provisions. Intervention is particularly needed in management fee cases if, as the bill provides, the burden of proving the unreasonableness of a particular fee rests throughout the case on the plaintiff.⁴ Since this is a heavy burden to be carried by a private party, the balance in favor of the fund and its advisor-underwriters, would be slightly redressed if the objector has the material support of the SEC. Accordingly, I favor enactment of the changes in Section 44 of the 1940 Act (as provided for in Section 23 of the Amendments).

⁴ I have indicated earlier my view that the burden should rest upon the defendants to prove the reasonableness of the fee. See pp. 803-804.