

Securities Regulation Daily Wrap Up, TOP STORY—M.D. Tenn.: Plaintiffs' Investment Company Act claims failed to meet threshold requirements, (Aug. 29, 2013)

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By Rodney F. Tonkovic, J.D.

A derivative action involving exchange-traded funds and alleged improprieties by their advisers was dismissed with prejudice by a district court. The action was brought by two pension funds that invested in mutual funds issued by iShares Trust and iShares, Inc. The plaintiffs' claims were dismissed without prejudice after the court found no private right of action for claims under Sections 47(b) and 36(a) and that a claim under Section 36(b) was barred by the statutory language (*Laborers' Local 256 Pension Fund v. iShares Trust*, August 28, 2013, Trauger, A.).

Defendant BlackRock Fund Advisors (BFA) manages and advises the iShares funds with respect to their investment activities. Defendant BlackRock Institutional Trust Company, N.A. (BTC), the corporate parent of BFA, provides securities lending services to the iShares investment companies and other funds. According to the complaint, BFA hired BTC to manage securities lending transactions on behalf of the iShares funds. BTC's management role is set forth pursuant to a securities lending agency agreement among BTC, the iShares companies, and the iShares funds.

Allegations. The lending agreement provides that BTC receives a fee of 35 percent of the net revenue earned from short-selling transactions. An additional 5 percent of that revenue is paid for administrative fees. This 40 percent total compensation to BFA and BTC is excessive compared to peer mutual funds employing unaffiliated lending agents, the complaint alleged.

The plaintiffs alleged that the lending agreement wrongly enriches the defendants at the expense of investors. Specifically, they asserted that the agreement provides excessive compensation in violation of Investment Company Act Section 36. The plaintiffs sought an injunction from continued lending, recovery of excessive compensation, rescission of the lending agreement, and other relief. The defendants countered that the plaintiffs failed to meet the pleading requirements for claims under the Act.

Section 36(b). The court first concluded that the Section 36(b) claim should be dismissed as to all defendants due to the express language of Section 36(b)(4). The court explained that Section 36(b)(4) provides that Section 36(b)'s private right of action to seek relief from breaches of fiduciary duty resulting in excessive compensation does not apply to compensation or payments made in connection with transactions subject to Section 17's prohibitions against agency relationships between affiliates. Here, the SEC granted BFA and BTC an exemption under Section 17 and approved the joint transaction under the terms of the exemption notice. Under Section 36(b)(4), the SEC's exemption removes the transactions from the scope of Section 36(b), the court stated.

Section 47(b). Next, the court dismissed the plaintiffs' claims under Section 47(b) because the section lacks an express or implied private right of action. Section 47(b) provides for the rescission of contracts that violate the Investment Company Act. Additionally, a plaintiff seeking relief under Section 47 may do so only after establishing a violation of another section of the Act.

In this case, the plaintiffs asserted violations of Sections 17(d), 17(e), 36(a), and 36(b). The court concluded that Sections 17(d), 17(e), and 36(a) do not include private rights of action and that the claim under Section 36(b) was barred by the statutory text (as discussed above). The court noted the presumption against implied rights of action as set forth by the U.S. Supreme Court in *Alexander v. Sandoval* (2001). Moreover, Section 47(b) only provides for a remedy, and it is settled in the Sixth Circuit that a remedy alone does not create a substantive right.

Section 36(a). The court also found no private right of action in Section 36(a). Section 36(a), the court stated, expressly permits the Commission to bring an action to enforce the provision. If Congress intended for a private

right of action in Section 36(a), the court explained, it would have expressly authorized one, as in Section 36(b). The claim was accordingly dismissed.

The case is No. 3:13-cv-00046.

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Companies: Laborers' Local 265 Pension Fund; Plumbers and Pipefitters Local No. 572 Pension Fund; iShares, Inc; iShares Trust; iShares Russell Midcap Index Fund; iShares MSCI EAFE Index Fund; iShares MSCI Emerging Markets Index Fund; iShares Russell 2000 Growth Index Fund; iShares Core S&P Mid Cap Index Fund; iShares Core S&P Small Cap Index Fund; iShares Dow Jones US Real Estate Index Fund; Blackrock Fund Advisors; Blackrock Institutional Trust Company, N.A.

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