10-1983

Daily Income Fund, Inc. v. Fox

Lewis F. Powell Jr.

(I agree, however, with CA2)

Resp., shareholder in money market Fund, sued Petrs - the Fund & its Investment Advisor, a derivative suit under Investment Co Act.

Petrs argue that demand should have been made on Bd of Directors to bring the suit.

CA2, noting that Act confers no express right on the Fund to sue but does confer right on shareholders.

Preliminary Memo

February 25, 1983 Conference
List 1, Sheet 4

CA2 declined to find an implied right of Fund to sue.

No. 82-1200

DAILY INCOME FUND, et al.

v.

FOX, MARTIN } Shareholder in money market fund

Timely

Cert to CA 2 (Kaufman, Feinberg & Friendly) } Strong court.

Federal/Civil

1. SUMMARY: Whether a shareholder's derivative action under §36(b) of the Investment Company Act of 1940 is exempt from the director demand requirement of Fed. Rule Civ. Proc. 23.1.

2. FACTS & PROCEEDINGS: Resp, a minority shareholder in a money market fund, instituted this derivative action under §36(b) of the Investment Company Act of 1940, 15 U.S.C. §80a-35(b),

This just came in. There is a conflict and the case looks important. I recommend granting. - RK against petrs (the fund and its investment advisor) to recover allegedly excessive advisory fees. No demand was made by the resp on the directors of the fund. Petrs therefore moved to dismiss the action for failure by resp to comply with the director demand requirement of Rule 23.1,[1] and that motion was granted by the District Court.

On appeal, the Second Circuit reversed, holding that Rule 23.1 does not apply to actions brought under §36(b). The court reasoned that §36(b) actions are not derivative because an investment company does not itself possess the right to bring an action against its advisor for return of allegedly excessive fees. The Rule 23.1 demand requirement applies only when a corporation has "failed to enforce a right which may properly be asserted by it." Fed. Rule Civ. Proc. 23.1. Thus, if the fund may not sue pursuant to §36(b), no demand upon its board of directors is required. The second sentence of §36(b) states that an action may be brought only "by the [Securities and Exchange] Commission, or by a security holder of [a] registered investment

CA2

[1]The demand requirement of Rule 23.1 provides: "The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort." The requirement finds its origin in Equity Rule 94, 104 U.S. IX (1882), which adopted the Court's holding in Hawes v. Oakland, 104 U.S. 450 (1881), that "before the shareholder is permitted in his own name to institute and conduct a litigation which usually belongs to the corporation, he should show to the satisfaction of the court that he has exhausted all the means within his reach to obtain, within the corporation itself, the redress of his grievances, or action in conformity to his wishes." 104 U.S., at 460-461.

Origin of "derivative" right of shareholders subject to prior demand company on behalf of such company." No action by the investment company is authorized. The legislative history of the Act indicates that the relationship of a fund to its investment advisor makes it "a part of the problem in a way that precludes it from being part of the solution" and hence the investment company was not intended to possess a right of action under §36(b). In addition, the board of directors of an investment company, unlike the boards in other derivative suits, have no power to terminate a §36(b) action. Finally, the delay caused by the director demand process may have the untoward result of precluding full recovery of excessive fees while the directors determine whether they had acted against the interest of shareholders, because §36(b) expressly limits recovery to excessive fees paid up to one year prior to the commencement of suit. Thus, for the above reasons, in the context of a §36(b) law suit, the director demand requirement would be "an empty, unfruitful and dilitory exercise."

3. CONTENTIONS: The decision below creates a conflict between the circuits, involves an important and unsettled question of federal law, and is erroneous. The decision below conflicts directly with Grossman v. Johnson, 674 F.2d 115 (CA 1), cert. denied, 103 S.Ct. 85, No. 81-2361 (1982), and Weiss v. Temporary Investment Fund, CCH Fed. Sec. L. Rep., ¶98, 865 (CA 3) Nov. 12, 1982.[2] The First and Third Circuits rejected every

[2]These opinions are reproduced in the Appendix to Petition.

argument relied on by the Court of Appeals below, and held that a demand on the directors is required in a shareholder's action brought under §36(b).

In view of the oversight role with respect to advisory fees which Congress gave to the unaffiliated directors of an investment company, the policy of exhaustion of intracorporate remedies has especially clear application to shareholders' derivative actions brought under §36(b). If the directors find the shareholders' claim has merit, they can negotiate with the advisor to obtain a return of fees, terminate the contract if the advisor refuses, or institute a §36(b) action.

The court erred in construing Congress' silence on an implied corporate right of action as indicating an intent to deprive an investment company of the right to bring such an action. An implied corporate right of action would further the purpose of the Act. In addition, the state of the law at the time Congress enacted §36(b) constitutes a background against which Congress should be presumed to have known that an investment company had its own right of action against its advisor. Merrill Lynch, Pierce, Fenner & Smith v. Curran, 102 S.Ct. 1825 (1982). Bad decision on implied right to sue

Even if an investment company does not have a right of action under §36(b), a shareholder's action under that provision is still derivative and must be preceded by a director demand. The statute authorizes shareholders to bring an action against an investment advisor "on behalf of" an investment company; this language clearly makes a shareholder's action derivative. Burkes

v. _Lasker_, 441 U.S. 471, 477 (1979), referred to §36(b) suits as "derivative." _Id._, at 484.

Resp acknowledges the Circuit Court conflict, but maintains that it is not of sufficient importance to warrant review because the director cannot terminate an action brought under §36(b). Moreover, the decision below is correct because where express remedies are created in some detail, as in §36(b), there should be no additional implied rights of action. The Court's holding in _Burkes_ v. _Lasker_ that a §36(b) action may not be terminated by a court simply because the board of directors urge it to do so reflects Congress' feeling that reliance on the board was ineffective in checking excessive advisory fees. Resp also notes that this circuit conflict was present when the Court denied rehearing in _Grossman_ v. _Fidelity Municipal Bond Fund_, _supra_, on January 10, 1983.

4. DISCUSSION: There is a direct conflict between the decision below and the decisions reached by the First and Third Circuits. The Second Circuit in this case noted that its decision conflicted with that of CA 1 in _Grossman_, and CA 3 noted in _Weiss_ that its decision conflicted with that of the Second Circuit in this case. No conflict existed when the Court denied cert in _Grossman_ and the petition for rehearing was untimely. As the parties' contentions indicate, there are strong arguments on both sides of the issue. If there is serious question about whether the conflict is sufficiently important in terms of the federal statute to justify review, the views of the Solicitor General could be requested. In light of the direct conflict

involving three decisions rendered in 1982, and on a subject which would appear to be the source of much litigation in the future, I recommend a GRANT. I see no jurisdictional problem; only one question is presented.

There is a response.

February 16, 1983 | Singer | Opinion in Petition

ME

February 25, 1983

Court	*Voted on*................., *19*...	
Argued ...., *19*...	*Assigned* ...., *19*...	No. 82-1200
Submitted ...., *19*...	*Announced* ...., *19*...	

DAILY INCOME FUND

vs.

FOX

Granted but B RW will take another look.

	HOLD FOR	CERT. G	CERT. D	JURISDICTIONAL STATEMENT N	POST	DIS	AFF	MERITS REV	AFF	MOTION G	D	ABSENT	NOT VOTING
Burger, Ch. J.			✓										
Brennan, J.		✓											
White, J.		✓											
Marshall, J.		✓											
Blackmun, J.		✓											
Powell, J.			✓										
Rehnquist, J.			✓										
Stevens, J.			✓										
O'Connor, J.			✓										

Court .... Voted on................., 19...
Argued ...., 19... Assigned ...., 19... No. 82-1200
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DAILY INCOME FUND

vs.

FOX

Grant

	HOLD FOR	CERT.		JURISDICTIONAL STATEMENT				MERITS		MOTION		ABSENT	NOT VOTING
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Burger, Ch. J.													
Brennan, J.													
White, J.													
Marshall, J.													
Blackmun, J.													
Powell, J.			✓										
Rehnquist, J.													
Stevens, J.													
O'Connor, J.													

I agree there is no implied ~~can~~ right of an investment fund (the corp. entity) to sue its "advisors" under § 36(b) the Act.

Therefore no derivative cause of action by shareholders - who have an explicit grant of a right to sue.

Affirm CA2.

BENCH MEMORANDUM

Daily Income Fund v. Fox

No. 82-1200

David A. Charny November 5, 1983

Question Presented

Whether a shareholder who brings suit to challenge advisory fees under section 36(b) of the Investment Company Act, 15 U.S.C. § 80a-35(b), must first make demand upon the company's board of directors.

Outline page

I. Background

A. Statutory Background

The Investment Company Act of 1940, now codified at 15 U.S.C. § 80a-1 et seq., was passed to regulate widespread abuses in the investment company industry. Investment companies are generally organized by another entity which appoints the board of directors and contracts with the company to manage its assets and to sell its shares. The 1940 Act was aimed at the grosser forms of its abuse which this structure permitted: dealing of the managers with corporate assets on terms unfair to the company; fraud in the sales of shares; excessive issuance of debt; and outright theft. The Act required registration of securities, limited companies' debt, required that directors otherwise unaffiliated with the company or its investment adviser sit on the board, and restricted transactions between the company and persons "affiliated" with it.

With the growth of investment companies after 1940, problems arose from more subtle conflicts of interest regarding compensation for services provided to the investment company -- brokerage commissions, sales loads, and advisory fees. The present suit involves determination of advisory fees. These fees were generally a fixed proportion of the total assets of the company. As companies grew, so did the total fee, although the costs of providing advisory services vary little with the size of the company. Although fees arrangements that might originally have been reasonable later became excessive, the board of directors did not re-negotiate the contract because it was yes dominated by the advisor. Shareholder suits were ineffective because of the stringent standards for proving "waste" of corporate assets.

investment advisor had a fiduciary duty under 1970 amend

The 1970 amendments to section 36 of the Investment Company Act, 15 U.S.C. § 80a-35(b), aimed at this problem. The amendments stipulated that the investment adviser had a fiduciary duty with respect of receipt of compensation and authorized shareholders or the SEC to sue investment advisors to recover excessive fees for the corporation. This case raises the question whether the shareholder must demand action from the company directors before brining suit under this section.

B. Facts and Proceedings Below

Resp, a shareholder in petr Daily Income Fund, an investment company, brought suit against petr Reich & Tang, Inc, petr Fund's investment adviser. The suit, brought on behalf on the Fund under section 36(b) of the Investment Company Act of 1940, 15 U.S.C. § 80a-35(b), alleged that Reich & Tang had charged excessive fee for its advisory services. Reich & Tang's fee was set at one-half of one percent of the Fund's net assets. Assets increased from $75 million in 1978 to $775 million in 1981; and the investment advisory fees increassed from $375,000 to $3,875,000. The complaint alleged that the work done by Reich & Tang for the company had not changed during this period.

Resp did not make any demand upon the Fund's directors. no demand The DC dismissed for failure to comply with the demand requirement of Fed. R. Civ. P. 23.1. After reviewing the purposes of Investment Company Act, the DC noted that demand on the directors would permit them to seek redress without resort to litigation or to institute a suit themselves. Further, the statute should be construed to harmonize with the Federal Rules if possible, and the court found no evidence in the legislative history that a demand requirement woud interfere with the regulation of investment advisory fees. Finally, the court noted that the Act provided that director approval of advisory fees "shall be given such consideration by the court as is deemed appropraite under all the circumstances." 15 U.S.C. § 80a-35(b)(2). A demand requirement would provide an opportunity for such deliberation. The DC then found that failure to make demand upon the fund's directors could not excused in the circumstances of this case.

The CA 2 (Judge Kaufman writing for Judges Friendly and Feinberg) reversed. Noting that rule 23.1 applied only if the shareholder suit sought to enforce a right which could be asserted by the corporation itself, the CA held that section 36(a) did not create a cause of action for the investment fund to recover fees. The language of the statute contained no suggestion of such a cause of action, and the legislative history confirmed that a corporate right of action was not contemplated because Congress considered that the investment fund's directors were too closely tied to the investment adviser to be expected to prosecute a suit for recovery of excessive fees. Finally, the court noted that its conclusion was consistent with the policies of section 36(b). A demand requirement would unjustifiably delay suit and thereby preclude complete recovery, and would serve

Strong Panel

CA2's views

little purpose because the directors could not decide to bring suit themselves and could not decide to terminate the suit.

The decision of the CA 2 is in conflict with those in Grossman v. Johnson 674 F.2d 115 (1st Cir. 1982), and Weiss v. Temporary Investment Fund, 692 F.2d 928 (3rd. Cir. 1982).

II. Discussion

A. Substantive Requirements of Rule 23.1

The government initially suggests that rule 23.1 is only a rule of pleading and imposes no substantive requirement that a demand be made. Therefore, the question in this case should properly be posed as whether the common law rule requiring demand will be imported into these derivative actions. ?

While the terms of Rule 23.1 might be read to impose only a requirement that the plaintiff plead with particularity whatever demand he chooses to make upon the directors, the lower courts have consistently interpreted the rule to impose a substantive requirement that the plaintiff carry an initial burden of "demonstrat[ing] why the directors are incapable of doing their duty." Heit v. Bird, 567 F.2d 1157 (1st Cir. 1977); In re Kauffman Mutual Fund Actions, 479 F.2d 257, 263 (1st Cir. 1973); Brody v. Chemical Bank, 482 F.2d 1111, 1113-1114 (2d Cir. 1973). In contrast, rule 23.1's requirement that plaintiffs make demand "if necessary" upon the shareholders or members has been interpreted to require demand only if required by the relevant state or federal substantive law. See Brody, supra, at 1114; 7A Wright and Miller, Federal Practice and Procedure, at § 1832. This distinction between demand on shareholders and directors

Rule 23.1 requires ~~the~~ demand when the corp. may sue suggests that courts have deliberately construed the rule 23.1 requirement of demand on directors as a requirement imposed directly by federal law, not simply adopted by reference to law that provides the basis for the shareholders cause of action.

The Court's discussion of the rule in Cohen v. Beneficial Loan Corp., 337 U.S. 541, 556 (1949) also implies that the rule embodies a direct requirement that demand be made. The ~~rule~~ Court construes the rule to require that the plaintiff "set forth the facts showing that the plaintiff has endeavored to obtain his remedy through the corporation itself." The Court went on to note that the provision so construed "neither create[s] nor exempt[s] from liabilities ...." Contrary to the government's submission on this issue, the demand requirement does not detract from any substantive right of the plaintiff. It merely requires that if a plaintiff wishes to bring an action in federal court which may properly be brought by the corporation itself, the plaintiff must first show good reason that the corporation itself would not be expected to bring the action.

Thus, the courts below correctly assume that a suit under section 36(b) is derivative and therefore triggers the rule 23.1 demand requirement unless the section 36(b) accomplishes an implied repeal of rule 23.1. Further, even if section 36(b) is not derivative, Congress may have intended that a demand requirement be enforced in this cause of action to enforce the policies behind the Act. I shall consider these points in turn.

??

We need not analyze in these terms

B. Applicability of Rule 23.1

Whether section 36(b) creates by implication a cause of action for the corporation is a question of congressional intent. Transamerica Mortgage Advisers, Inc. v. Lewis, 444 U.S. 11, 15-16 (1979). It seems clear that Congress did not create such a remedy here. First, while section 36(b) explicitly creates rights of sction on the part of the SEC and individual security holders, it gives absolutely no indication that the corporation has a right of action. As the Court has frequently observed, clear contrary evidence of legislative intent is required to overcome the presumption that the express provision by Congress for one remedy precludes implication of other remedies by the courts. See National RR Passenger Corp. v. National Assn of RR Passengers (Amtrak), 414 U.S. 453, 458 (1974); Middlesex County Sewerage Authority v. National Sea Clammers Assn., 453 U.S. 1, 14-15 (1981); Texas Indust. v. Radcliff Materials, Inc., 451 U.S. 630, 640 n.11 (1981). Further, it is particularly remarkable that Congress did not include any reference to suit by the investment company itself or of derivative suits by shareholders enforcing the company's rights, because, as the SG notes, earlier drafts of the law contained such provisions. SG Brief at 18-19.

yes

I agree

Nor is there any mention of a demand requirement of the statute itself. Although Congress expressly indicated that approval of the contract by the board of directors of an investment company "shall he given such consideration by the court as is deemed appropriate," 15 U.S.C. § 80a-35(b)(2), the statute contains absolutely no intimation that Congress expected that some action by the Board of director would be forth coming before a suit was filed under the Act.

Petrs concede, as did the courts of appeals which found that there was an implied right of action in the company, that there is no explicit indication in the legislative history of intent to create this right. See Weiss, 692 F.2d, at 935. Rather, the courts contend that the legislative silence indicates that "Congress did not intend to restrict company's right to sue." Id.; Grossman, 694 F.2d at 120. First, it is contended that Congress meant to preserve the pre-1970 law, under which there was a common law action for corporate waste under the law of the states, and an implied derivative right of action under section 36. E.g., Moses v. Burgin, 445 F.2d 369 (1st. Cir. 1971). Second, given the requirement that suit must be brought "on behalf of the investment company," "it was unnecessary to say with particularity that the company" had a statutory cause of action. A suit on behalf of the company ... is normally a derivative action that the company could itself bring."

The first argument relies upon the holding of Merrill Lynch, Pierce, Fenner & Smith v. Curran, 456 U.S. 353, 381-382 (1982) that when Congress "left intact the statutory provisions under which the federal courts had implied a cause of action," Congress intended to "preserve" that cause of action. Whatever the merits of this argument, compare id., at 408 (JUSTICE POWELL, dissenting) (theory is "inconsistent with the theory and structure of our constituitonal government"), it is inapplicable to the present case. Unlike the provision at issue in Merrill

Bad decision

Yes

Lynch, section 36(b) is not "left intact" from previous legislation; it is totally new.

Further, Congress expressly indicated that it did not consider that section 36(b) codified the implied derivative action of such cases as Moses v. Burgin, which had relied on the language now in section 36(a), but created a distinct right. "Although section 36(b) provides for an equitable action for breach of fiduciary duty as does section 36(a), the fact that subsection (b) specifically provides for private right of action should not be read by implication to affect subsecton (a)." S. Rep. 91-184, at 16 (1969). Section 36(b) creates and provides for enforcment of a specific fiduciary duty on the part of investment advisors with respect to compensation, in contrast to the general duties of officers addressed by old section 36, and present section 36(a), of the Act. Id. at 6-7. Thus, Congress considered section 36(b) provides for suit to enforce a right of the corporation not previously recognized either in state law or in the private cause of action for misconduct of corporate officers under old rule 36.

Finally, the section 36(b) action would not be derivative of the state law cause of action for waste. The terms of rule 23.1, as well as the purposes behind the demand requirement, strongly suggest that a shareholder suit is derivative when the shareholder seeks to enforce the "same right" as the corporation itself could enforce if it chose to bring suit after demand was made. The suggestion of amicus Investment Company Institute to the contrary, see Amicus Br. at 10, is unsupported by the cases. Further, the legislative history condemns state law suits as inadequate to vindicate the company's interests because of the stringent requirements for proof of "waste." See S. Rep., at 5. It would therefore be particularly anomalous in this case to consider the shareholder's federal cause of action derivative of that provided to the corporation under state law.

The Act's use of the phrase "on behalf of such company," does suggest a congressional understanding that the suit is derivative. Although the CA below argued that the phrase indicated only that the plaintiff must "seek return of excessive management fees to the company treasury and not to individual or governmental coffers," it seems natural to assume that, if the corporation has the right to receive this recovery, it has a right to sue for it on its own behalf.

Although this point is troubling, petr's argument seems to mistake the limits on the exercise of federal court jurisdiction and the corresponding requirements for creation of the cause of action. While section 36(b) well may indicate that Congress recognized that the investment company had a right not to pay excessive fees, this recognition does not resolve the question whether Congress intended to open the federal courts to suits by the company asserting this right require prior demand upon directors. As noted above, section 36(b) creates a distinct right, and there is no indication that Congress intended this right to be enforced in any way but those specifically provided by that section. Given the care with which Congress indicates that it is creating a new cause of action with respect to a new federally-created right, it seems anomalous that Congress intended the corporation itself did bring suit for the right in federal court, but simply assumed that this was so obvious that it would neither provide a basis for jurisdiction or for the cause of action in the relevant section.

C. Policy Arguments Concerning a Demand Requirement

Even if Congress did not create a right of action for which section 36(b) is derivative, Congress might have intended that a demand requirement be imposed in order to further the purposes of the Act. The CA below correctly determined however that on balance the demand requirement woud hinder rather than aid effective enforcement of section 36(b).

demand would hinder enforcement

The primary purpose of the demand requirement is to permit the corporation itself to control litigation purportedly conducted on its behalf. Hawes v. Oakland, 104 U.S. 450, 460-461 (1882); Note, The Demand and Standing Requirements in Stockholder Derivative Actions, 44 U Chi L. Rev. 168, 171 (1976). "[T]he focus at the demand stage should be on the issue of whether the corporation may take over the suit and either prosecute it or adopt other internal corrective measures.... At the demand stage, the possibility should not be foreclosed that a demand will induce the board to consider issues and crystallize policies which otherwise might not be given attention ...." ALI Restatement on Principles of Corporate Governance and Structures § 7.02, at 270-271 (1982).

As a matter of policy, whether to impose a demand requirement in the present case depends upon competing views of the role of the board of directors. On the one hand, as the CA 3 emphasized, Congress in 1970 intended to "enhance the independence of directors and their responsibility for advisory fees." It did so by expanding the class of those "interested persons," id. §80a-2(19) (previously termed "affiliated persons") who can constitute no more than 60% of the investment company board of directors. 15 U.S.C. § 80a-10. Congress retained the provisions of the 1940 Act which required that contracts with advisers be approved annually by a vote of the board of directors (or of the shareholders), id., § 80a-15(a)(2), and be terminable by a vote of the board with six days' notice to the adviser, id., par. (3). Congress clearly intended that the board undertake an active role in supervising fees paid to advisers. A demand requirement might help the board fulfill this responsibility. If a shareholder made demand upon the board, the board might obviate the need for suit by insisting that the investment adviser either refund the excessive payments or have his contract terminated.

On the other hand, the board's power to control the suit is limited. The board does not have the power to terminate the suit, see Burks v. Lasker, 441 U.S. 471, 484 (1979) (construing section 36(b)(2)), and, as argued above, cannot bring suit itself. (If it could, the shareholder suit would be derivative and the present discussion would be superfluous.) Further, the legislative history seems to indicate, contrary to the assumption of the CA 3, that Congress did not expect that the board would not use the measures available to it to curb advisory fee abuses. The basic outlines of the regulations on the board of directors were in place with the 1940, and Congress found that these had not effectively checked the specific problems at which the 1970 amendments were addressed. S. Rep. No. 91-184, at 6. Indeed, the provisions of the 1940 had not been intended to do so, as they were aimed at "unfair capital strucures and ... dishonest securities transactions with insiders" rather than "managerial compensation." H. Rep. No. 2337, at 66 (1966) (Report of the SEC on Investment Company Growth).

Further, Congress did not think of the 1970 reforms that strengthened the independence of the Board as solutions to the conflict of interest regarding managerial compensation. Neither the House nor the Senate reports make any connection between the changes in the definition "interested persons" and the problem of management fees. Indeed, while the Senate report gives great emphasis to the provision for shareholder suits, it does not even mention the "interested persons" requirement in its summary discussion of the bill. See S. Rep., at 5-13. And the legislative history indicates that the board was not thought to be free, as a practical matter, to terminate established management relationships when differences arose over compensation. For that reason, "even a requirement that all of the directors of an externally managed investment company be persons unaffiliated with the company's adviser-underwriter would not be an effective check on advisory fees and other forms of management compensation." H. Rep. No. 2337, at 148. If conflicts of interest make "arms-length bargaining between the unaffiliated irectors and the managers ... wholly unrealistic" in the first instance, id., it is difficult to see why Congress would have expected the boards more effectively to protect the company's interests once a demand has been made upon the board.

Nowhere does the legislative history indicate that Congress explicitly considered whether the board might be responsive to a shareholder demand made in anticipation of suit. Such demand might spur effective action at least in a few cases. But because the investment advisors' contract must be approved every year after the first two years, any demand for suit will follow closely upon a decision by the board that the contract was in the best interests of the corporation. Further, as the CA 2 observed, the one-year statute of limitations on recoveries, 15 U.S.C. § 80a-35(b)(3) means that delay while the demand is considered prevents the company from fully recovering excessive profits.

Thus, the advantages of the demand requirement in this context are not so apparent that the Court should construe the provision that the shareholder sues "on behalf of" the company, or section 36(b) as a whole, to require demand upon the board. I do not think that Congress simply assumed that the courts would impose such a requirement as a matter of course. Where Congress has wished to impose a demand requirement for shareholder suits created by statute, it has explicitly imposed such a requirement. See 15 U.S.C. § 78p(b) (shareholder suing to recover insider "short swing" profits for the corporation only "if the issuer

shall fail or refuse to bring such suit ... after request ...").
Particularly where Congress, in creating a shareholder cause of action, has addressed in detail such matters as the appropriate parties, the limits on recovery, the weight to be given to the board of directors vote, and the power of the board of directors to terminate the suit, it seems unlikely that Congress would leave the demand requirement to be inferred by judicial construction.

III. Conclusion

Because the section 36(b) shareholder action is not derivative, section 23.1 does not require that the shareholder make demand upon the board before bringing suit. Nor do the terms of section 36(b) indicate that Congress intended directly to impose such a requirement. For these reasons, the judgment below should be affirmed.

agree

lfp/ss 11/07/83 INCOME SALLY-POW

82-1200 Daily Income Fund v. Fox

MEMO TO FILE:

This memo, dictated without the benefit of a bench memo, merely summarizes my tentative view at this time.

The case is an interesting one: a derivative action brought by respondent, a shareholder in petitioner money market fund, under §36(b) of the Investment Company Act of 1940. Although the fund was a named defendant, the principal defendant was its investment adviser whose fees had soared in excess of $2 million. The suit was to recover excessiver advisory fees as authorized by §36(b).

No demand was made by respondent on the directors of the fund prior to bringing the derivative suit. On a motion to dismiss for this reason, the DC held that the plaintiff (respondent here) had failed to make a demand on the fund as required by Rule 23.1. CA2 reversed, holding that Rule 23.1 does not apply to actions brought under §36(b). That section was added to the Investment Company Act in 1970 specifically for the purpose of authorizing stockholder suits against investment advisers. In pertinent part §36(b) provides:

"An action may be brought under this subsection by the Commission, or by a security holder . . . on behalf of such company, against such investment adviser . . . or any other person . . . who has a fiduciary duty . . . for breach of [that] fiduciary duty in respect to compensation or payments paid . . . to such investment adviser."

Rule 23.1 that normally requires a demand on the board of directors, was held by CA2 not to be applicable in view of the express language of §36(b).

Siting my opinion in Sea Clammers, CA2 declined to infer a private right of action by the investment company itself:

"When Congress has provided specific and elaborate enforcement provisions, and entrusted their use to particular particular parties, we will not lightly assume an unexpressed intention to create additional ones". (citing Sea Clammers).

There was, at the time of the CA2 suit, a contrary decision by the First Circuit: Grossman v. Johnson. CA2 rejected CA1's reasoning in Grossman. Since CA2's decision, however, CA3 has agreed with CA1.

My tentative view is that CA2 is correct: that no private cause of action may be inferred against the fund, and therefore Rule 23.1 with respect to demand is inapplicable.

L.F.P., Jr.

ss

82-1200 DAILY INCOME FUND v. FOX Argued 11/7/83

Rule 23.1 is a rule of procedure,
section 36(b).

Pollack (Petr) (competent lawyer)

CA 2 said co. itself had no right to sue.

The suit is "derivative" suit — as said by Burks v. Lasker 441 U.S. 471, 477, 484

Rule ~~#~~23.1 applies to all "derivative" suit.

Leg. hist. is silent as to implied cause of action. Thus must look to state of law at time § 36(b) was ~~enacted~~ enacted & law was clear in 1970 that a shareholder's right to sue ~~i~~ is derivative.

x x x

Named Fund as Δ because recovery ~~of the~~ goes to it. Fund is a "nominal" Δ

This was said by Myers in his argument for Resp.

Meyer (Resp) (competent counsel also)

S.E.C. ~~has~~ was concerned by ineffectiveness of directors in controlling fees.

§ 23.1 applies only when the company has not brought an action it could to have brought. (CA2's op. 18a)

Directors wholly dependent on advisers

Issue in this case is congressional intent. (Cort v Ash)

Prior to 1970 ~~no~~ no Investment Co had sued its advisors. Thus, no reason for Congress to have thought the Co would sue if given a right.

SEC - like shareholders - may sue under 36(b). If Co requested SEC to sue, it probably would sue if suit is justified.

(Invest. Cos. are quite dif. from ordinary corps.)

Affirm 8-1

No. 82-1200, Daily Income Fund v. Fox Conf. 11/9/83

The Chief Justice Affirm
Close quest - but CA 2 opinion is strong.
Would not imply a cause of action.
Leg. hist. supports CA 2

Justice Brennan Affirm
In light of leg. hist, this was not a derivative action
§ 36(b) is ~~#~~ explicit.

Justice White Affirm
Agrees with WJB that 36(b) is specific & not subject to Rule 23.1

Justice Marshall Aff'm

Justice Blackmun Aff.

Strong CA2 panel (yes)

Rule 23 is procedural - pleading requirement,

Company may have an implied action & then s/h would not require a demand in view of provisions of 36(b)

Rule 23.1 is subject to qualification by express Act of Congress

Justice Powell Aff'm

CA2 (Friendly on panel) reasoning is sound.

536(b) provides explicitly for suit by shareholders or the Commission.

Only reference to Bd of Directors ~~is~~ is to say that the court may give consideration to approval by Bd of the compensation.

Congress knew how to provide for demand on Bd. as predicate for suit. See 16(b), Act '34 - suit to recover short term profits where Corp. fails to sue

Justice Rehnquist Rev.

CA3 view is sounder than CA2.

Rule 23.1 controls.

Corp. does not have a cause of action ~~to~~ itself

Justice Stevens Affirm

If Rule 23.1 applies, there was no violation.

This was a 36(b) action & the ~~[illegible]~~ Πs did all there ~~the~~ was required

Justice O'Connor Affirm

Agree essentially with my views.

On a first reading, this is an excellent opinion except for a question as to Part III discussion of the "implied cause of action" issue - p12 - 18.
On p 12, in particular, the "factors" to be considered do not include availability of other remedies. This is mentioned - almost in passing - on p 17 when Scadlamner is cited as a see also.

Justice White
Justice Marshall
Justice Blackmun
Justice Powell
Justice Rehnquist
Justice Stevens
Justice O'Connor

From: **Justice Brennan**

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1st DRAFT

SUPREME COURT OF THE UNITED STATES

No. 82-1200

DAILY INCOME FUND, INC. AND REICH & TANG, INC., PETITIONERS *v.* MARTIN FOX

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

[January ——, 1984]

JUSTICE BRENNAN delivered the opinion of the Court.

The question for decision is whether Rule 23.1 of the Federal Rules of Civil Procedure requires that an investment company security holder first make a demand upon the company's board of directors before bringing an action under §36(b) of the Investment Company Act of 1940 (ICA or Act) to recover allegedly excessive fees paid by the company to its investment adviser. The Court of Appeals for the Second Circuit held in this case that the demand requirement of Rule 23.1 does not apply to such actions. *Fox* v. *Reich & Tang, Inc.*, 692 F. 2d 250 (CA2 1982). Two other Courts of Appeals have reached a contrary conclusion.[1] We granted certiorari to resolve the conflict, —— U. S. —— (1983), and now affirm.

I

Respondent is a shareholder of petitioner Daily Income Fund, Inc. ("Fund"), an open-end diversified management investment company, or "mutual fund," regulated by the Investment Company Act of 1940 ("ICA" or "Act"), 15 U. S. C. §80a-1 *et seq.* The Fund invests in a portfolio of short-term money market instruments with the aim of achieving high

I joined after W & B agreed to add the cites I suggested. See my letter

[1] *Weiss* v. *Temporary Investment Fund, Inc.*, 692 F. 2d 928 (CA3 1982), cert. pending, No. 82-1592; *Grossman* v. *Johnson*, 674 F. 2d 115 (CA1), cert. denied, —— U. S. —— (1982).

current income while preserving capital. Under a written contract, petitioner Reich & Tang, Inc. ("R&T") provides the Fund with investment advice and other management services in exchange for a fee currently set at one-half of one percent of the Fund's net assets. From 1978 to 1981, the Fund experienced substantial growth; its net assets increased from about $75 million to $775 million. During this period, R&T's fee of one-half of one percent of net assets remained the same. Accordingly, annual payments by the Fund to R&T rose from about $375,000 to an estimated $3,875,000 in 1981.

Alleging that these fees were unreasonable, respondent brought this action in the United States District Court for the Southern District of New York, naming both the Fund and R&T as defendants. The complaint alleged that, because the Fund's assets had been continually reinvested in a limited number of instruments, R&T's investment decisions had remained routine and substantially unchanged as the Fund grew. By receiving significantly higher fees for essentially the same services, R&T had, according to respondent, violated the fiduciary duty owed investment companies by their advisers under § 36(b) of the ICA. Pub. L. No. 91–547, Section 20, 84 Stat. 1428, 15 U. S. C. § 80a–35(b).[2] The

[2] Section 36(b) of the ICA provides, in relevant part:

"For the purposes of this subsection, the investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser. An action may be brought under this subsection by the Commission, or by a security holder of such registered investment company on behalf of such company, against such investment adviser, or any affiliated person of such investment adviser, or any other person enumerated in subsection (a) of this section who has a fiduciary duty concerning such compensation or payments, for breach of fiduciary duty in respect of such compensation or payments paid by such registered investment company or by the security holders thereof to such investment adviser or person." 15 U. S. C. § 80a–35(b).

complaint sought damages in favor of the Fund as well as payment of respondent's costs, expenses, and attorney's fees.

Petitioners moved to dismiss the suit for failure to comply with Fed. Rule Civ. Proc. 23.1, which governs "a derivative action brought by one or more shareholders . . . to enforce a right of a corporation . . . , the corporation . . . having failed to enforce a right which may properly be asserted by it. . . ." The Rule requires a shareholder bringing such a suit to set forth "the efforts, if any, made by the plaintiff to obtain the action he desires from the directors . . . , and the reasons for his failure to obtain the action or for not making the effort."[3] Respondent contended that the Rule 23.1 "demand requirement" does not apply to actions brought under § 36(b) of the

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Section 36(b) goes on to provide, *inter alia*, that proof of a defendant's misconduct is unnecessary, § 80a–35(b)(1), that approval by the board of directors or shareholders of the adviser's compensation "shall be given such consideration by the court as is deemed appropriate under all the circumstances," § 80a–35(b)(2), and that recovery is limited to actual damages for a period of one year prior to suit, § 80a–35(b)(3).

[3] Rule 23.1 provides in full:

"In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would otherwise not have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs."

ICA and that, in any event, demand was excused because the Fund's directors had participated in the alleged wrongdoing and would be hostile to the suit. The district court, finding Rule 23.1 applicable to § 36(b) actions and finding no excuse based on the directors' possible self-interest or bias, dismissed the action. *Fox* v. *Reich & Tang, Inc.*, 94 F.R.D. 94 (SDNY 1982).

The Court of Appeals reversed. *Fox* v. *Reich & Tang, Inc.*, 692 F. 2d 250 (CA2 1982). The court concluded that Rule 23.1 by its terms applies only when the corporation could itself "'assert,' in a court, the same action under the same rule of law on which the shareholder plaintiff relies." *Id.*, at 254. Relying on both the language and the legislative history of § 36(b), the court determined that an investment company may not itself sue under that section to recover excessive adviser fees. *Id.*, at 254–261. Accordingly, the court held that Rule 23.1 does not apply to actions by security holders brought under § 36(b). *Id.*, at 261.

II

Although any action in which a shareholder asserts the rights of a corporation could be characterized as "derivative," see n. 11 *infra*, Rule 23.1 applies in terms only to a "derivative action brought by one or more shareholders or members to enforce a right of a corporation [when] the corporation [has] *failed to enforce a right which may properly be asserted by it*" (emphasis added). This qualifying language suggests that the type of derivative action governed by the Rule is one in which a shareholder claims a right that could have been, but was not, "asserted" by the corporation in court. The "right" mentioned in the emphasized phrase, which cannot sensibly mean any right without limitation, is most naturally understood as referring to the same right, or at least its substantial equivalent, as the one asserted by the plaintiff shareholder. And, in the context of a rule of judicial procedure, the reference to the corporation's "failure to enforce a right which may properly be asserted by it" obviously presupposes that the right in question could be enforced by the corporation in court. yes

This interpretation of the Rule is consistent with the understanding we have expressed, in a variety of contexts, of the term "derivative action." In *Hawes* v. *City of Oakland*, 104 U. S. 450, 460 (1882), for instance, the Court explained that a derivative suit is one "founded on a right of action existing in the corporation itself, and in which the corporation itself is the appropriate plaintiff." Similarly, *Cohen* v. *Beneficial Loan Corp.*, 337 U. S. 541, 548 (1949), stated that a derivative action allows a stockholder "to step into the corporation's shoes and to seek in its right the restitution he could not demand in his own"; and the Court added that such a stockholder "brings suit on a cause of action derived from the corporation." *Id.*, at 549. Finally, *Ross* v. *Bernhard*, 396 U. S. 531, 534 (1970), described a derivative action as "a suit to enforce a *corporate* cause of action against officers, directors, and third parties" (emphasis in original) and viewed the question there presented—whether the Seventh Amendment confers a right to a jury in such an action—as the same as whether the corporation, had it brought the suit itself, would be entitled to a jury. *Id.*, at 538–539. In sum, the term "derivative action," which defines the scope of Rule 23.1, has long been understood to apply only to those actions in which the right claimed by the shareholder is one the corporation could itself have enforced in court. See also *Koster* v. *Lumbermen's Mutual Casualty Co.*, 330 U. S. 518, 522 (1947); *Price* v. *Gurney*, 324 U. S. 100, 105 (1945); *Delaware & Hudson R.R. Co.* v. *Albany & Susquehana R.R. Co.*, 213 U. S. 435, 447 (1909).[4]

[4] One commentator has explained that "the derivative suit may be viewed as the consolidation in equity of, on the one hand, a suit by the shareholder against the directors in their official capacity, seeking an affirmative order that they sue the alleged wrongdoers, and, on the other, a suit by the corporation against these wrongdoers." Note, Demand on Di-

The origin and purposes of Rule 23.1 support this understanding of its scope. The Rule's provisions derive from this Court's decision in *Hawes* v. *City of Oakland*, *supra*. Prior to *Hawes*, federal courts exercising their equity powers had commonly entertained suits by minority stockholders to enforce corporate rights in circumstances where the corporation had failed to sue on its own behalf. *Id.*, at 452. See *Dodge* v. *Woolsey*, 18 How. 331, 339 (1855); 7A C. Wright & A. Miller, Federal Practice and Procedure § 1821, at 296–297 (1972). The Court in *Hawes*, while emphasizing the importance of such suits as a means of "protecting the stockholder against the frauds of the governing body of directors or trustees," 104 U. S., at 453, noted that this equitable device was subject to two kinds of potential abuse. First, corporations that were engaged in disputes with citizens of their home state could collude with out-of-state stockholders to obtain diversity jurisdiction in order to litigate the dispute in the federal courts. *Id.*, at 452–453. Second, derivative actions brought by minority stockholders could, if unconstrained, undermine the basic principle of corporate governance that the decisions of a corporation—including the decision to initiate litigation—should be made by the board of directors or the majority of shareholders. See *id.*, at 454–457.

To address these problems, the Court in *Hawes* established a number of prerequisites to bringing derivative suits in the

rectors and Shareholders as a Prerequisite to a Derivative Suit, 73 Harv. L. Rev. 746, 748 (1960). The Court in *Hawes* embraced this conception of the suit as consolidating "two causes of action," 104 U. S., at 452, and referred throughout its opinion to a derivative action as "one in which the right of action [is] in the company," *id.*, at 455; see *id.*, at 457 (cases impose limits on "the right of a stockholder to sue in cases where the corporation is the proper party to bring the suit"). See also *Corbus* v. *Alaska Treadwell Gold Mining Co.*, 187 U. S. 455, 463 (1903) (describing rules governing derivative suits as limiting situations in which "a court of equity may be called upon at the appeal of any single stockholder to compel the directors of the corporation to enforce every right which it may possess, irrespective of other considerations"); Black's Law Dictionary 1272 (5th ed., 1979).

federal courts. These requirements were designed to limit the use of the device to situations in which, due to an unjustified failure of the corporation to act for itself, it was appropriate to permit a shareholder "to institute and conduct a litigation which usually belongs to the corporation." *Id.*, at 460. With some additions and changes in wording, the conditions set out in *Hawes* have been carried forward in successive revisions of the federal rules.[5]

yes

Some of the requirements first announced in *Hawes* were intended to reduce the burden on the federal courts by diverting corporate causes of action "to the State courts, which are their natural, their lawful, and their appropriate forum." *Id.*, at 452–453.[6] At the same time, however, the Court

[5] Shortly after *Hawes* was decided, the Court codified its requirements in Equity Rule 94, which provided:

"Every bill brought by one or more shareholders in a corporation, against the corporation and other parties, founded on rights which may properly be asserted by the corporation, must be verified by oath, and must contain an allegation that the plaintiff was a shareholder at the time of the transaction of which he complains, or that his share had devolved on him since by operation of law; and that the suit is not a collusive one to confer on a court of the United States jurisdiction of a case it would not otherwise have cognizance. It must also set forth with particularity the efforts of the plaintiff to secure such action as he desires on the part of the managing directors or trustees and, if necessary, of the shareholders, and the cause of his failure to obtain such action." 104 U. S. IX (1882).

In 1912, the Court replaced the original rule with Equity Rule 27, identical to its predecessor except that it added at the very end the phrase "or the reasons for not making such effort." This language was apparently intended to codify a judicially recognized exception to the old rule in certain circumstances where, in the discretion of the court, a demand may be excused. See *Delaware & Hudson R.R. v. Albany & Susquehanna R.R.*, 213 U. S. 435 (1909).

When the federal rules were promulgated in 1937, the provisions of Equity Rule 27 were substantially restated in Rule 23(b). See 3B J. Moore & J. Kennedy, Moore's Federal Practice ¶23.1.15[1], at p. 23.1–10 (2d ed. 1982). Finally, in 1966, the present version of new Rule 23.1 was adopted as part of a comprehensive revision of the rules governing class actions. See *id.*, ¶23.1.01, at p. 23.1–3.

sought to maintain derivative suits as a limited exception to the usual rule that the proper party to bring a claim on behalf of a corporation is the corporation itself, acting through its directors or the majority of its shareholders. *Id.*, at 460–461. As the Court later explained, this aspect of the rules governing derivative suits reflects the basic policy that "[w]hether or not a corporation shall seek to enforce in the courts a cause of action for damages is, like other business questions, ordinarily a matter of internal management and is left to the discretion of the directors, in the absence of instruction by vote of the stockholders." *United Copper Securities Co.* v. *Amalgamated Copper Co.*, 244 U. S. 261, 263 (1917). See also *Corbus* v. *Alaska Treadwell Gold Mining Co.*, 187 U. S. 455, 463 (1903).[7]

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[6] In particular, the Court required the complaint in a derivative suit to allege that the plaintiff "was a shareholder at the time of the transactions of which he complains, or that his shares have devolved on him since by operation of law, and that the suit is not a collusive one to confer on a court of the United States jurisdiction in a case of which it could otherwise have no cognizance. . . ." 104 U. S., at 461. The second of these requirements was clearly meant to discourage efforts to bring disputes between a company and citizens of the state of incorporation within the diversity jurisdiction of the federal courts. See *supra*, at ——; 3 B J. Moore & J. Kennedy, *supra*, ¶23.1.15[1], at p. 23.1–14. Although the first requirement may also have been intended to discourage contrived diversity suits, see *id.*, ¶23.1.15[1], at p. 23.1–15, it is now understood as generally "aimed at preventing the federal courts from being used to litigate purchased grievances." 7A C. Wright & A. Miller, Federal Practice and Procedure § 1828, at pp. 341–342 (1972).

[7] Like the requirements adopted in *Hawes*, the two major features of Rule 23.1 added since that decision—the requirement that the plaintiff "fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association" and the provision requiring notice and court approval of settlements—are also intended to prevent shareholders from suing in place of the corporation in circumstances where the action would disserve the legitimate interests of the company or its shareholders. See generally 7A C. Wright & A. Miller, *supra*, §§ 1833 & 1839; 3B J. Moore & J. Kennedy, *supra*, ¶¶ 23.1.16[3] & 23.1.24.

The principal means by which the Court in *Hawes* sought to vindicate this policy was, of course, its requirement that a shareholder seek action by the corporation itself before bringing a derivative suit. 104 U. S., at 460–461.[6] This "demand requirement" affords the directors an opportunity to exercise their reasonable business judgment and "waive a legal right vested in the corporation in the belief that its best interests will be promoted by not insisting on such right. They may regard the expense of enforcing the right or the furtherance of the general business of the corporation in determining whether to waive or insist upon the right." *Corbus* v. *Alaska Treadwell Gold Mining Co.*, 187 U. S. 455, 463 (1903). On the other hand, if, in the view of the directors, "litigation is appropriate, acceptance of the demand places the resources of the corporation, including its information, personnel, funds, and counsel, behind the suit." Note, The Demand and Standing Requirements in Stockholder Derivative Actions, 44 U. Chi. L. Rev. 168, 171–172 (1976) (footnote omitted). Like the Rule in general, therefore, the provisions regarding demand assume a lawsuit that could be

[6] Although the Court in *Hawes* imposed a direct requirement that shareholders make demand on directors before bringing suit, 104 U. S., at 460–461, Rule 23.1 as presently written requires only that a shareholder's "complaint shall also allege with particularity the efforts, *if any*, made by the plaintiff to obtain the action he desires from the directors or comparable authority. . . . "(emphasis added). Relying on the emphasized qualification, added to the Rule without comment by the drafters in 1966, see n. 4, *supra*, the Securities and Exchange Commission (SEC), appearing as *amicus curiae*, contends that the Rule does not itself oblige the shareholder to make a demand; instead, it simply requires the plaintiff to plead compliance with applicable obligations of substantive law, ordinarily that of the state of incorporation. See *Burks* v. *Lasker*, 441 U. S. 471, 478 (1979). Because we conclude that a suit brought under § 36(b) of the Investment Company Act is not a "derivative action" for purposes of Rule 23.1, see *infra*, at ——, we need not decide whether the Rule itself, as a matter of federal procedure, makes demand on directors the predicate to a proper derivative suit in federal courts or whether any such obligation must instead be found in applicable substantive law.

yes

controlled by the corporation's board of directors.[9]

In sum, the conceptual basis and purposes of Rule 23.1 confirm what its language suggests: the Rule governs only suits "to enforce a right of a corporation" when the corporation itself has "failed to enforce a right which may properly be asserted by it" in court. In this case, therefore, we must decide whether the right asserted by a shareholder suing under § 36(b) of the Investment Company Act could be judicially enforced by the investment company.[10] We turn to consider that question.

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[9] Petitioners point out that, even in cases where the corporation could not control the shareholder's lawsuit, a demand on directors affords management an opportunity to pursue non-judicial remedies for the shareholder's grievance. But however desirable the encouragement of intracorporate remedies may be as a matter of policy, it is not, standing alone, enough to make a suit that the corporation can neither initiate nor terminate a "derivative action" within the meaning of Rule 23.1. Such a suit does not come within the Rule's language as it is most naturally interpreted and as we have consistently understood it. See *supra*, at ——. Moreover, the Rule and its predecessors were directed at ensuring that the proper party was before the court in a certain class of cases, see *supra*, at ——, and a shareholder action that the corporation cannot control raises no proper party concerns.

[10] Petitioners contend that, even if an investment company could not bring a suit under § 36(b), a shareholder's action under that section is nevertheless derivative for purposes of Rule 23.1 because the investment company has a similar right to recover excessive fees from its investment adviser under a state law cause of action for corporate waste. See, *e. g.*, *Llewellyn* v. *Queen City Dairy, Inc.*, 48 A. 2d 322, 326 (Md. 1946). The fact that the corporation may be able to achieve some of the results contemplated by § 36(b) under state law does not, however, demonstrate that a shareholder's action brought under an independent federal statute claims "a right which may properly be asserted" by the corporation. See *supra*, at ——. The new right created by § 36(b) is not only formally distinct from that asserted in a state claim of corporate waste; it is substantively different as well. Indeed, an important reason for the enactment of § 36(b) was Congress's belief that the standards applied in corporate waste actions were inadequate to ensure reasonable adviser fees. As the Senate Committee that reported the bill that became § 36(b) explained:

III

In determining whether § 36(b) confers a right that could be judicially enforced by an investment company, we look first, of course, at the language of the statute. As noted above, *supra* at —— and n. 1, § 36(b) imposes a fiduciary duty on an investment company's adviser "with respect to the receipt of compensation for services" paid by the company and provides that "[a]n action may be brought under this subsection by the [Securities and Exchange] Commission, or by a security holder of such registered investment company on behalf of such company" against the adviser and other affiliated parties. By its terms, then, the unusual cause of action created by § 36(b) differs significantly from those traditionally asserted in shareholder derivative suits. Instead of establishing a corporate action from which a shareholder's right to sue derivatively may be inferred, § 36(b) expressly provides that the new corporate right it creates may be enforced only by the Securities and Exchange Commmission (SEC) and security holders of the company.[11]

Under general rules of law, advisory contracts which are ratified by the shareholders, or in some States approved by a vote of the disinterested directors, may not be upset in the courts except upon a showing of "corporate waste." As one court put it, the fee must "Shock the conscience of the court." Such a rule may not be an improper one when the protections of arm's-length bargaining are present. But in the mutual fund industry where[] these marketplace forces are not likely to operate as effectively, your committee has decided that the standard of "corporate waste" is unduly restrictive and recommends that it be changed." S. Rep. No. 91–184, p. 5 (1970)

See *infra*, at —— and n. 12.

[11] Petitioners argue that, because § 36(b) provides for an action "by a security holder of such registered investment company *on behalf of such company*" (emphasis added), such an action is necessarily derivative. In this regard, petitioners rely on this Court's statement in *Burks* v. *Lasker*, 441 U. S. 471, 477 (1979) that a "derivative suit is brought by shareholders to enforce a claim *on behalf of* the corporation" (emphasis added). See also *id.*, at 484 (referring to actions brought under § 36(b) as "derivative"). The "on behalf" language indicates, however, only that the right asserted

Implied cause of action

intent of Congress

availability of other remedies

Petitioners nevertheless contend that an investment company has an implied right of action under § 36(b). In evaluating such a claim, our focus must be on the intent of Congress when it enacted the statute in question. *Merrill Lynch, Pierce, Fenner & Smith* v. *Curran*, 456 U. S. 353, 377–378 (1982). That intent may in turn be discerned by examining a number of factors, including the legislative history and purposes of the statute, the identity of the class for whose particular benefit the statute was passed, and the traditional role of the states in affording the relief claimed. *Ibid.*; *California* v. *Sierra Club*, 451 U. S. 287, 292–293 (1981); *Cannon* v. *University of Chicago*, 441 U. S. 677 (1979); *Cort* v. *Ash*, 422 U. S. 66, 78 (1975). In this case, consideration of each of these factors plainly demonstrates that Congress intended the unique right created by § 36(b) to be enforced solely by the SEC and security holders of the investment company.

As we have previously noted, Congress adopted the Investment Company Act of 1940 because of its concern with "the potential for abuse inherent in the structure of investment companies." *Burks* v. *Lasker*, 441 U. S. 471, 480 (1979). Unlike most corporations, an investment company is typically created and managed by a pre-existing external organization known as an investment adviser. *Id.*, at 481.

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by a shareholder suing under § 36(b) is a "right of the corporation"—a proposition confirmed by other aspects of the action: The fiduciary duty imposed on advisers by § 36(b) is owed to the company itself as well as its shareholders and any recovery obtained in a § 36(b) action will go to the company rather than the plaintiff. See S. Rep. No. 91-184, p. 6 (1970); § 36(b)(3). In this respect, a § 36(b) action is undeniably "derivative" in the broad sense of that word. See *supra*, at ——. As we have noted, however, Rule 23.1 applies by its terms only to "a derivative action brought by one or more shareholders . . . to enforce a right of a corporation [when] the corporation [has] *failed to enforce a right which may properly be asserted by it*" (emphasis added). *Ibid.* The legislative history of § 36(b) makes clear that Congress intended the perhaps unique "right of a corporation" established by § 36(b) to be asserted by the company's security holders and not by the company itself. *Infra*, at ——.

Because the adviser generally supervises the daily operation of the fund and often selects affiliated persons to serve on the company's board of directors, the "relationship between investment advisers and mutual funds is fraught with potential conflicts of interest." *Ibid., quoting Galfand* v. *Chestnutt Corp.*, 545 F. 2d 807, 808 (CA2 1976). In order to minimize such conflicts of interests, Congress established a scheme that regulates most transactions between investment companies and their advisers, 15 U. S. C. § 80a-17; limits the number of persons affiliated with the adviser who may serve on the fund's board of directors, § 80a-10; and requires that fees for investment advice and other services be governed by a written contract approved both by the directors and the shareholders of the fund, § 80a-15.

In the years following passage of the Act, investment companies enjoyed enormous growth, prompting a number of studies of the effectiveness of the Act in protecting investors. One such report, commissioned by the SEC, found that investment advisers often charged mutual funds higher fees than those charged the advisers' other clients and further determined that the structure of the industry, even as regulated by the Act, had proven resistant to efforts to moderate adviser compensation. Wharton School Study of Mutual Funds, H. R. Rep. No. 2274, 87th Cong., 2d Sess., pp. 28-30, 34, 66-67 (1962). Specifically, the study concluded that the unaffiliated directors mandated by the Act were "of restricted value as an instrument for providing effective representation of mutual fund shareholders in dealings between the fund and its investment adviser." *Id.*, at 34. A subsequent report, authored by the SEC itself, noted that investment advisers were generally compensated on the basis of a fixed percentage of the fund's assets, rather than on services rendered or actual expenses. Securities & Exchange Commission, Public Policy Implications of Investment Company Growth, H. R. Rep. No. 89-2337, p. 89 (1966) (hereinafter SEC Report). The Commission determined that, as a fund's assets grew, this form of payment could produce unreasonable fees in light of the economies of scale realized in managing a larger portfolio. *Id.*, at 94, 102. Furthermore, the Commission concluded that lawsuits by security holders challenging the reasonableness of adviser fees had been largely ineffective due to the standards employed by courts to judge the fees. *Id.*, at 132–143. See *infra*, at —— and n. 12.

In order to remedy this and other perceived inadequacies in the Act, the SEC submitted a series of legislative proposals to Congress that led to the 1970 Amendments to the Act. Some of the proposals Congress ultimately adopted were intended to make the fund's board of directors more independent of the adviser and to encourage greater scrutiny of adviser contracts. See, *e. g.*, 15 U. S. C. § 80a–10(a) (requiring that at least 40% of the directors not be "interested persons," a broader category than the previously identified group of persons "affiliated" with the adviser, see § 80a–2(a)(19)); § 80a–15(c) (requiring independent directors as well as shareholders to approve adviser contracts); *Burks* v. *Lasker*, *supra*, 441 U. S., at 482–483. The SEC had, however, determined that approval of adviser contracts by shareholders and independent directors could not alone provide complete protection of the interests of security holders with respect to adviser compensation. See SEC Report, *supra*, at p. 128–131, 144, 146–147. Accordingly, the Commission also proposed amending the Act to require "reasonable" fees. *Id.*, at 143–147. As initially considered by Congress, the bill containing this proposal would have empowered the SEC to bring actions to enforce the reasonableness standard and to intervene in any similar action brought by or on behalf of the company. H. R. 9510, 90th Cong., 1st Sess. § 8(d) (1967); S. 1659, 90th Cong., 1st Sess. § 8(d) (1967).

Representatives of the investment company industry, led by amicus Investment Company Institute (ICI), expressed concern that enabling the SEC to enforce the fairness of adviser fees might in essence provide the Commission with rate-making authority. Accordingly, ICI proposed an alternative to the SEC bill which would have provided that actions to enforce the reasonableness standard "be brought only by the company or a security holder thereof on its behalf." Mutual Fund Legislation of 1967: Hearings on S. 1659 Before the Senate Committee on Banking and Currency, 90th Cong., 1st Sess., Pt. 1, at pp. 100–101 (1967) (hereinafter 1967 Hearings). The version that the Senate finally passed, however, rejected the industry's suggestion that the investment company itself be expressly authorized to bring suit. S. 3724, 90th Cong., 2d Sess. § 8(d)(6) (1968). Instead, the Senate bill required a security holder to make demand on the SEC before bringing suit and provided that, if the Commission refused or failed to bring an action within six months, the security holder could maintain a suit against the adviser in a "derivative" or representative capacity. *Ibid.* Like the original SEC proposal, however, the Senate bill provided that the SEC could intervene in any action brought by the company or by a security holder on its behalf. *Id.*, § 22.

After the bill was reintroduced in the 91st Congress, further hearings and consultations with the industry led to the present version of § 36(b). See S. 2224, 91st Cong., 1st Sess. § 20(b) (1969); 115 Cong. Rec. 13648 (1969) (Statement of Sen. McIntyre). The new version adopted "a different method of testing management compensation." S. Rep. No. 91–184, at p. 5 (1969). Instead of containing a statutory standard of "reasonableness," the new version imposed a "fiduciary duty" on investment advisers. *Id.*, at pp. 5–6. The new bill further provided that "either the SEC or a shareholder may sue in court on a complaint that a mutual fund's management fees involve a breach of fiduciary duty." *Id.*, at 7. The reference in the previous bill to the derivative or representative nature of the security holder action was eliminated, as was the earlier provision for intervention by the SEC in actions brought by the investment company itself. See S. 2224, *supra*, § 22.

In short, Congress rejected a proposal that would have expressly made the statutory standard governing adviser fees enforceable by the investment company itself and adopted in its place a provision containing none of the indications in earlier drafts that the company could bring such a suit. This legislative history strongly suggests that, in adopting § 36(b), Congress did not intend to create an implied right of action in favor of the investment company.

That conclusion is further supported by the purposes of the statute. As noted above, the SEC proposed the predecessor to § 36(b) because of its concern that the structural requirements for investment companies imposed by the Act would not alone ensure reasonable adviser fees. See *supra*, at ——. Indeed, the Commission concluded that the Act's provisions for independent directors and approval of adviser contracts had actually frustrated effective challenges to adviser fees. In particular, the Commission noted that in the three fully litigated cases in which security holders had attacked such fees under state law, the courts had relied on the approval of adviser contracts by security holders or unaffiliated directors to uphold the fees. SEC Report, *supra*, at p. 132–143.[12] For this reason, the Senate Report proposing the final version of the statute noted that, while shareholder and directorial approval of the adviser's contract are entitled to

[12] In the three cases cited by the SEC, the courts had evaluated the adviser contracts according to common law standards of corporate waste, under which an unreasonable or unfair fee might be approved unless the court deemed it "unconscionable" or "shocking." SEC Report, *supra*, at 142. See *Acampora* v. *Birkland*, 220 F. Supp. 527, 548–549 (D. Colo. 1963); *Saxe* v. *Brady*, 40 Del. Ch. 474, 486, 184 A. 2d 602, 610 (1962); *Meiselman* v. *Eberstadt*, 39 Del. Ch. 563, 170 A. 2d 720, 723 (1961). Similarly, security holders challenging adviser fees under the Investment Company Act itself had been required to prove gross abuse of trust. See *Brown* v. *Bullock*, 194 F. Supp. 207 (SDNY 1961), *aff'd*, 294 F. 2d 415 (CA2 1961). See 1967 Hearings, *supra*, at 117–118.

serious consideration by the court in a § 36(b) action, "such consideration would not be controlling in determining whether or not the fee encompassed a breach of fiduciary duty." S. Rep. No. 91-184, at p. 15 (1969); see *id.*, at p. 5. In contrast to its approach in other aspects of the 1970 amendments, then, Congress decided not to rely solely on the fund's directors to assure reasonable adviser fees, notwithstanding the increased disinterestedness of the board. See *Burks* v. *Lasker*, *supra*, 441 U. S., at 481–482 n. 10 and 484. See also SEC Report, *supra*, at 146–148 (right of SEC and security holders to bring actions essential; although role of disinterested directors should be enhanced, "even a requirement that all of the directors of an externally managed investment company be persons unaffiliated with the company's adviser-underwriter would not be an effective check on advisory fees and other forms of management compensation"). This policy choice strongly indicates that Congress intended security holder and SEC actions under § 36(b), on the one hand, and directorial approval of adviser contracts, on the other, to act as independent checks on excessive fees.

Nor do other factors on which we have relied to identify an implied cause of action support petitioners' claim that the right asserted by a shareholder in a § 36(b) action could be enforced by the investment company. First, investment companies, as well as the investing public, are undoubtedly within "the class for whose *especial* benefit" § 36(b) was enacted, *Cort* v. *Ash*, *supra*, 422 U. S., at 78 (emphasis in original), see n. 11, *supra*. Section § 36(b)'s express provision for actions by security holders, however, ensures that, even if the company's directors cannot bring an action in the fund's name, the company's rights under the statute can be fully vindicated by plaintiffs authorized to act on its behalf. For this reason, it is unnecessary to infer a right of action in favor of the corporation in order to serve the statute's "broad remedial purpose." *Cf.*, *Herman & MacLean* v. *Huddleston*, —— U. S. ——, —— (1983). See also *Middlesex County*

yes

Sewerage Authority v. *National Sea Clammers Ass'n.*, 453 U. S. 1, 13, 15 (1981). Second, because § 36(b) creates an entirely new right, it was obviously not enacted "in a statutory context in which an implied private remedy [had] already been recognized by the courts." *Cf., Merrill Lynch, Pierce, Fenner & Smith* v. *Curran, supra*, 456 U. S., at 378; *Herman & MacLean* v. *Huddleston, supra*, at ——. Third, a corporation's rights against its directors or third parties with whom it has contracted are generally governed by state, not federal, law. *Burks* v. *Lasker, supra*, 441 U. S., at 478. See *Cort* v. *Ash, supra*, 422 U. S., at 78.

IV

A shareholder derivative action is an exception to the normal rule that the proper party to bring a suit on behalf of a corporation is the corporation itself, acting through its directors or a majority of its shareholders. Accordingly, Rule 23.1, which establishes procedures designed to prevent minority shareholders from abusing this equitable device, is addressed only to situations in which shareholders seek to enforce a right that "may properly be asserted" by the corporation itself. In contrast, as the language of § 36(b) indicates, Congress intended the fiduciary duty imposed on investment advisers by that statute to be enforced solely by security holders of the investment company and the SEC. It would be anomalous, therefore, to apply a Rule intended to prevent a shareholder from improperly suing in place of the corporation to a statute, like § 36(b), conferring a right which the corporation itself cannot enforce. It follows that Rule 23.1 does not apply to an action brought by a shareholder under § 36(b) of the Investment Company Act and that the plaintiff in such a case need not first make a demand upon the fund's directors before bringing suit.

The judgment of the Court of Appeals is therefore

Affirmed.

December 30, 1983

82-1200 Daily Income Fund v. Fox

Dear Bill:

I think your opinion is excellent, and expect to join you.

On page 12 when to address the "implied right of action" issue, you identify the "factors" from which legislative intent may be discerned. I would appreciate your adding one factor that our cases clearly have established, namely, whether Congress has provided other remedies that are adequate to serve the legislative purpose. This is fully supported by Middlesex County, 453 U.S. 1, 13, that you joined. To the same effect is TransAmerica Mortgage Advisors, 444 U.S. 11, 15, that we cited in Middlesex.

Sincerely,

Justice Brennan

lfp/ss

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE THURGOOD MARSHALL

January 3, 1984

Re: No. 82-1200-Daily Income Fund v. Fox

Dear Bill:

Please join me.

Sincerely,

T.M.

T.M.

Justice Brennan

cc: The Conference

January 3, 1984

<u>82-1200 Daily Income Fund v. Fox</u>

Dear Bill:

Please join me.

Sincerely,

Justice Brennan

lfp/ss

cc: The Conference

CHAMBERS OF
JUSTICE WILLIAM H. REHNQUIST

January 3, 1984

Re: No. 82-1200 Daily Income Fund v. Fox

Dear Bill:

You have persuaded me. I join.

Sincerely,

Justice Brennan

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE WM. J. BRENNAN, JR.

January 3, 1984

No. 82-1200

Daily Income Fund v. Fox

Dear Lewis,

It will be done.

Sincerely,

Bill

Justice Powell

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE SANDRA DAY O'CONNOR

January 3, 1984

No. 82-1200 Daily Income Fund, Inc. v. Fox

Dear Bill,

Please join me.

Sincerely,

Sandra

Justice Brennan

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE BYRON R. WHITE

January 3, 1984

Re: 82-1200 - Daily Income Fund, Inc.
and Reich & Tang v. Fox

Dear Bill,

Please join me.

Sincerely,

Byron

Justice Brennan

Copies to the Conference

cpm

Stylistic & 11-12

Justice Marshall
Justice Blackmun
Justice Powell
Justice Rehnquist
Justice Stevens
Justice O'Connor

I've joined

From: **Justice Brennan**

Circulated: ____________

Recirculated: 1/4/84

~~1st~~ 2d DRAFT

SUPREME COURT OF THE UNITED STATES

No. 82-1200

DAILY INCOME FUND, INC. AND REICH & TANG, INC., PETITIONERS *v.* MARTIN FOX

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

[January ——, 1984]

JUSTICE BRENNAN delivered the opinion of the Court.

The question for decision is whether Rule 23.1 of the Federal Rules of Civil Procedure requires that an investment company security holder first make a demand upon the company's board of directors before bringing an action under § 36(b) of the Investment Company Act of 1940 (ICA or Act) to recover allegedly excessive fees paid by the company to its investment adviser. The Court of Appeals for the Second Circuit held in this case that the demand requirement of Rule 23.1 does not apply to such actions. *Fox* v. *Reich & Tang, Inc.*, 692 F. 2d 250 (CA2 1982). Two other Courts of Appeals have reached a contrary conclusion.[1] We granted certiorari to resolve the conflict, —— U. S. —— (1983), and now affirm.

I

Respondent is a shareholder of petitioner Daily Income Fund, Inc. ("Fund"), an open-end diversified management investment company, or "mutual fund," regulated by the Investment Company Act of 1940 ("ICA" or "Act"), 15 U. S. C. § 80a-1 *et seq.* The Fund invests in a portfolio of short-term money market instruments with the aim of achieving high

[1] *Weiss* v. *Temporary Investment Fund, Inc.*, 692 F. 2d 928 (CA3 1982), cert. pending, No. 82-1592; *Grossman* v. *Johnson*, 674 F. 2d 115 (CA1), cert. denied, —— U. S. —— (1982).

current income while preserving capital. Under a written contract, petitioner Reich & Tang, Inc. ("R&T") provides the Fund with investment advice and other management services in exchange for a fee currently set at one-half of one percent of the Fund's net assets. From 1978 to 1981, the Fund experienced substantial growth; its net assets increased from about $75 million to $775 million. During this period, R&T's fee of one-half of one percent of net assets remained the same. Accordingly, annual payments by the Fund to R&T rose from about $375,000 to an estimated $3,875,000 in 1981.

Alleging that these fees were unreasonable, respondent brought this action in the United States District Court for the Southern District of New York, naming both the Fund and R&T as defendants. The complaint alleged that, because the Fund's assets had been continually reinvested in a limited number of instruments, R&T's investment decisions had remained routine and substantially unchanged as the Fund grew. By receiving significantly higher fees for essentially the same services, R&T had, according to respondent, violated the fiduciary duty owed investment companies by their advisers under § 36(b) of the ICA. Pub. L. No. 91-547, Section 20, 84 Stat. 1428, 15 U. S. C. § 80a-35(b).[2] The

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[2] Section 36(b) of the ICA provides, in relevant part:

"For the purposes of this subsection, the investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser. An action may be brought under this subsection by the Commission, or by a security holder of such registered investment company on behalf of such company, against such investment adviser, or any affiliated person of such investment adviser, or any other person enumerated in subsection (a) of this section who has a fiduciary duty concerning such compensation or payments, for breach of fiduciary duty in respect of such compensation or payments paid by such registered investment company or by the security holders thereof to such investment adviser or person." 15 U. S. C. § 80a-35(b).

complaint sought damages in favor of the Fund as well as payment of respondent's costs, expenses, and attorney's fees.

Petitioners moved to dismiss the suit for failure to comply with Fed. Rule Civ. Proc. 23.1, which governs "a derivative action brought by one or more shareholders . . . to enforce a right of a corporation . . . , the corporation . . . having failed to enforce a right which may properly be asserted by it. . . ." The Rule requires a shareholder bringing such a suit to set forth "the efforts, if any, made by the plaintiff to obtain the action he desires from the directors . . . , and the reasons for his failure to obtain the action or for not making the effort."[3] Respondent contended that the Rule 23.1 "demand requirement" does not apply to actions brought under § 36(b) of the

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Section 36(b) goes on to provide, *inter alia*, that proof of a defendant's misconduct is unnecessary, § 80a–35(b)(1), that approval by the board of directors or shareholders of the adviser's compensation "shall be given such consideration by the court as is deemed appropriate under all the circumstances," § 80a–35(b)(2), and that recovery is limited to actual damages for a period of one year prior to suit, § 80a–35(b)(3).

[3] Rule 23.1 provides in full:

"In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would otherwise not have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs."

ICA and that, in any event, demand was excused because the Fund's directors had participated in the alleged wrongdoing and would be hostile to the suit. The district court, finding Rule 23.1 applicable to § 36(b) actions and finding no excuse based on the directors' possible self-interest or bias, dismissed the action. *Fox* v. *Reich & Tang, Inc.*, 94 F. R. D. 94 (SDNY 1982).

The Court of Appeals reversed. *Fox* v. *Reich & Tang, Inc.*, 692 F. 2d 250 (CA2 1982). The court concluded that Rule 23.1 by its terms applies only when the corporation could itself "'assert,' in a court, the same action under the same rule of law on which the shareholder plaintiff relies." *Id.*, at 254. Relying on both the language and the legislative history of § 36(b), the court determined that an investment company may not itself sue under that section to recover excessive adviser fees. *Id.*, at 254–261. Accordingly, the court held that Rule 23.1 does not apply to actions by security holders brought under § 36(b). *Id.*, at 261.

II

Although any action in which a shareholder asserts the rights of a corporation could be characterized as "derivative," see n. 11 *infra*, Rule 23.1 applies in terms only to a "derivative action brought by one or more shareholders or members to enforce a right of a corporation [when] the corporation [has] *failed to enforce a right which may properly be asserted by it*" (emphasis added). This qualifying language suggests that the type of derivative action governed by the Rule is one in which a shareholder claims a right that could have been, but was not, "asserted" by the corporation in court. The "right" mentioned in the emphasized phrase, which cannot sensibly mean any right without limitation, is most naturally understood as referring to the same right, or at least its substantial equivalent, as the one asserted by the plaintiff shareholder. And, in the context of a rule of judicial procedure, the reference to the corporation's "failure to enforce a right which may properly be asserted by it" obviously presupposes that the right in question could be enforced by the corporation in court.

This interpretation of the Rule is consistent with the understanding we have expressed, in a variety of contexts, of the term "derivative action." In *Hawes* v. *City of Oakland*, 104 U. S. 450, 460 (1882), for instance, the Court explained that a derivative suit is one "founded on a right of action existing in the corporation itself, and in which the corporation itself is the appropriate plaintiff." Similarly, *Cohen* v. *Beneficial Loan Corp.*, 337 U. S. 541, 548 (1949), stated that a derivative action allows a stockholder "to step into the corporation's shoes and to seek in its right the restitution he could not demand in his own"; and the Court added that such a stockholder "brings suit on a cause of action derived from the corporation." *Id.*, at 549. Finally, *Ross* v. *Bernhard*, 396 U. S. 531, 534 (1970), described a derivative action as "a suit to enforce a *corporate* cause of action against officers, directors, and third parties" (emphasis in original) and viewed the question there presented—whether the Seventh Amendment confers a right to a jury in such an action—as the same as whether the corporation, had it brought the suit itself, would be entitled to a jury. *Id.*, at 538–539. In sum, the term "derivative action," which defines the scope of Rule 23.1, has long been understood to apply only to those actions in which the right claimed by the shareholder is one the corporation could itself have enforced in court. See also *Koster* v. *Lumbermen's Mutual Casualty Co.*, 330 U. S. 518, 522 (1947); *Price* v. *Gurney*, 324 U. S. 100, 105 (1945); *Delaware & Hudson R. Co.* v. *Albany & Susquehana R. Co.*, 213 U. S. 435, 447 (1909).[4]

[4] One commentator has explained that "the derivative suit may be viewed as the consolidation in equity of, on the one hand, a suit by the shareholder against the directors in their official capacity, seeking an affirmative order that they sue the alleged wrongdoers, and, on the other, a suit by the corporation against these wrongdoers." Note, Demand on Di-

The origin and purposes of Rule 23.1 support this understanding of its scope. The Rule's provisions derive from this Court's decision in *Hawes* v. *City of Oakland*, *supra*. Prior to *Hawes*, federal courts exercising their equity powers had commonly entertained suits by minority stockholders to enforce corporate rights in circumstances where the corporation had failed to sue on its own behalf. *Id.*, at 452. See *Dodge* v. *Woolsey*, 18 How. 331, 339 (1855); 7A C. Wright & A. Miller, Federal Practice and Procedure § 1821, at 296–297 (1972). The Court in *Hawes*, while emphasizing the importance of such suits as a means of "protecting the stockholder against the frauds of the governing body of directors or trustees," 104 U. S., at 453, noted that this equitable device was subject to two kinds of potential abuse. First, corporations that were engaged in disputes with citizens of their home state could collude with out-of-state stockholders to obtain diversity jurisdiction in order to litigate the dispute in the federal courts. *Id.*, at 452–453. Second, derivative actions brought by minority stockholders could, if unconstrained, undermine the basic principle of corporate governance that the decisions of a corporation—including the decision to initiate litigation—should be made by the board of directors or the majority of shareholders. See *id.*, at 454–457.

To address these problems, the Court in *Hawes* established a number of prerequisites to bringing derivative suits in the

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rectors and Shareholders as a Prerequisite to a Derivative Suit, 73 Harv. L. Rev. 746, 748 (1960). The Court in *Hawes* embraced this conception of the suit as consolidating "two causes of action," 104 U. S., at 452, and referred throughout its opinion to a derivative action as "one in which the right of action [is] in the company," *id.*, at 455; see *id.*, at 457 (cases impose limits on "the right of a stockholder to sue in cases where the corporation is the proper party to bring the suit"). See also *Corbus* v. *Alaska Treadwell Gold Mining Co.*, 187 U. S. 455, 463 (1903) (describing rules governing derivative suits as limiting situations in which "a court of equity may be called upon at the appeal of any single stockholder to compel the directors of the corporation to enforce every right which it may possess, irrespective of other considerations"); Black's Law Dictionary 1272 (5th ed., 1979).

federal courts. These requirements were designed to limit the use of the device to situations in which, due to an unjustified failure of the corporation to act for itself, it was appropriate to permit a shareholder "to institute and conduct a litigation which usually belongs to the corporation." *Id.*, at 460. With some additions and changes in wording, the conditions set out in *Hawes* have been carried forward in successive revisions of the federal rules.[5]

Some of the requirements first announced in *Hawes* were intended to reduce the burden on the federal courts by diverting corporate causes of action "to the State courts, which are their natural, their lawful, and their appropriate forum." *Id.*, at 452–453.[6] At the same time, however, the Court

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[5] Shortly after *Hawes* was decided, the Court codified its requirements in Equity Rule 94, which provided:

"Every bill brought by one or more shareholders in a corporation, against the corporation and other parties, founded on rights which may properly be asserted by the corporation, must be verified by oath, and must contain an allegation that the plaintiff was a shareholder at the time of the transaction of which he complains, or that his share had devolved on him since by operation of law; and that the suit is not a collusive one to confer on a court of the United States jurisdiction of a case it would not otherwise have cognizance. It must also set forth with particularity the efforts of the plaintiff to secure such action as he desires on the part of the managing directors or trustees and, if necessary, of the shareholders, and the cause of his failure to obtain such action." 104 U. S. IX (1882).

In 1912, the Court replaced the original rule with Equity Rule 27, identical to its predecessor except that it added at the very end the phrase "or the reasons for not making such effort." This language was apparently intended to codify a judicially recognized exception to the old rule in certain circumstances where, in the discretion of the court, a demand may be excused. See *Delaware & Hudson R. Co.* v. *Albany & Susquehanna R. Co.*, 213 U. S. 435 (1909).

When the federal rules were promulgated in 1937, the provisions of Equity Rule 27 were substantially restated in Rule 23(b). See 3B J. Moore & J. Kennedy, Moore's Federal Practice ¶23.1.15[1], at p. 23.1–10 (2d ed. 1982). Finally, in 1966, the present version of new Rule 23.1 was adopted as part of a comprehensive revision of the rules governing class actions. See *id.*, ¶23.1.01, at p. 23.1–3.

sought to maintain derivative suits as a limited exception to the usual rule that the proper party to bring a claim on behalf of a corporation is the corporation itself, acting through its directors or the majority of its shareholders. *Id.*, at 460–461. As the Court later explained, this aspect of the rules governing derivative suits reflects the basic policy that "[w]hether or not a corporation shall seek to enforce in the courts a cause of action for damages is, like other business questions, ordinarily a matter of internal management and is left to the discretion of the directors, in the absence of instruction by vote of the stockholders." *United Copper Securities Co.* v. *Amalgamated Copper Co.*, 244 U. S. 261, 263 (1917). See also *Corbus* v. *Alaska Treadwell Gold Mining Co.*, 187 U. S. 455, 463 (1903).[7]

[6] In particular, the Court required the complaint in a derivative suit to allege that the plaintiff "was a shareholder at the time of the transactions of which he complains, or that his shares have devolved on him since by operation of law, and that the suit is not a collusive one to confer on a court of the United States jurisdiction in a case of which it could otherwise have no cognizance. . . ." 104 U. S., at 461. The second of these requirements was clearly meant to discourage efforts to bring disputes between a company and citizens of the state of incorporation within the diversity jurisdiction of the federal courts. See *supra*, at 6; 3 B J. Moore & J. Kennedy, *supra*, ¶23.1.15[1], at p. 23.1–14. Although the first requirement may also have been intended to discourage contrived diversity suits, see *id.*, ¶23.1.15[1], at p. 23.1–15, it is now understood as generally "aimed at preventing the federal courts from being used to litigate purchased grievances." 7A C. Wright & A. Miller, Federal Practice and Procedure §1828, at pp. 341–342 (1972).

[7] Like the requirements adopted in *Hawes*, the two major features of Rule 23.1 added since that decision—the requirement that the plaintiff "fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association" and the provision requiring notice and court approval of settlements—are also intended to prevent shareholders from suing in place of the corporation in circumstances where the action would disserve the legitimate interests of the company or its shareholders. See generally 7A C. Wright & A. Miller, *supra*, §§1833 & 1839; 3B J. Moore & J. Kennedy, *supra*, ¶¶23.1.16[3] & 23.1.24.

The principal means by which the Court in *Hawes* sought to vindicate this policy was, of course, its requirement that a shareholder seek action by the corporation itself before bringing a derivative suit. 104 U. S., at 460–461.[5] This "demand requirement" affords the directors an opportunity to exercise their reasonable business judgment and "waive a legal right vested in the corporation in the belief that its best interests will be promoted by not insisting on such right. They may regard the expense of enforcing the right or the furtherance of the general business of the corporation in determining whether to waive or insist upon the right." *Corbus* v. *Alaska Treadwell Gold Mining Co.*, 187 U. S. 455, 463 (1903). On the other hand, if, in the view of the directors, "litigation is appropriate, acceptance of the demand places the resources of the corporation, including its information, personnel, funds, and counsel, behind the suit." Note, The Demand and Standing Requirements in Stockholder Derivative Actions, 44 U. Chi. L. Rev. 168, 171–172 (1976) (footnote omitted). Like the Rule in general, therefore, the provisions regarding demand assume a lawsuit that could be

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[5] Although the Court in *Hawes* imposed a direct requirement that shareholders make demand on directors before bringing suit, 104 U. S., at 460–461, Rule 23.1 as presently written requires only that a shareholder's "complaint shall also allege with particularity the efforts, *if any*, made by the plaintiff to obtain the action he desires from the directors or comparable authority. . . . "(emphasis added). Relying on the emphasized qualification, added to the Rule without comment by the drafters in 1966, see n. 4, *supra*, the Securities and Exchange Commission (SEC), appearing as *amicus curiae*, contends that the Rule does not itself oblige the shareholder to make a demand; instead, it simply requires the plaintiff to plead compliance with applicable obligations of substantive law, ordinarily that of the state of incorporation. See *Burks* v. *Lasker*, 441 U. S. 471, 478 (1979). Because we conclude that a suit brought under § 36(b) of the Investment Company Act is not a "derivative action" for purposes of Rule 23.1, see *infra*, at 18, we need not decide whether the Rule itself, as a matter of federal procedure, makes demand on directors the predicate to a proper derivative suit in federal courts or whether any such obligation must instead be found in applicable substantive law.

controlled by the corporation's board of directors.[9]

In sum, the conceptual basis and purposes of Rule 23.1 confirm what its language suggests: the Rule governs only suits "to enforce a right of a corporation" when the corporation itself has "failed to enforce a right which may properly be asserted by it" in court. In this case, therefore, we must decide whether the right asserted by a shareholder suing under § 36(b) of the Investment Company Act could be judicially enforced by the investment company.[10] We turn to consider that question.

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[9] Petitioners point out that, even in cases where the corporation could not control the shareholder's lawsuit, a demand on directors affords management an opportunity to pursue non-judicial remedies for the shareholder's grievance. But however desirable the encouragement of intracorporate remedies may be as a matter of policy, it is not, standing alone, enough to make a suit that the corporation can neither initiate nor terminate a "derivative action" within the meaning of Rule 23.1. Such a suit does not come within the Rule's language as it is most naturally interpreted and as we have consistently understood it. See *supra*, at 4–5. Moreover, the Rule and its predecessors were directed at ensuring that the proper party was before the court in a certain class of cases, see *supra*, at 6–10, and a shareholder action that the corporation cannot control raises no proper party concerns.

[10] Petitioners contend that, even if an investment company could not bring a suit under § 36(b), a shareholder's action under that section is nevertheless derivative for purposes of Rule 23.1 because the investment company has a similar right to recover excessive fees from its investment adviser under a state law cause of action for corporate waste. See, *e. g.*, *Llewellyn* v. *Queen City Dairy, Inc.*, 48 A. 2d 322, 326 (Md. 1946). The fact that the corporation may be able to achieve some of the results contemplated by § 36(b) under state law does not, however, demonstrate that a shareholder's action brought under an independent federal statute claims "a right which may properly be asserted" by the corporation. See *supra*, at 4–5. The new right created by § 36(b) is not only formally distinct from that asserted in a state claim of corporate waste; it is substantively different as well. Indeed, an important reason for the enactment of § 36(b) was Congress's belief that the standards applied in corporate waste actions were inadequate to ensure reasonable adviser fees. As the Senate Committee that reported the bill that became § 36(b) explained:

III

In determining whether § 36(b) confers a right that could be judicially enforced by an investment company, we look first, of course, at the language of the statute. As noted above, *supra* at 2 and n. 2, § 36(b) imposes a fiduciary duty on an investment company's adviser "with respect to the receipt of compensation for services" paid by the company and provides that "[a]n action may be brought under this subsection by the [Securities and Exchange] Commission, or by a security holder of such registered investment company on behalf of such company" against the adviser and other affiliated parties. By its terms, then, the unusual cause of action created by § 36(b) differs significantly from those traditionally asserted in shareholder derivative suits. Instead of establishing a corporate action from which a shareholder's right to sue derivatively may be inferred, § 36(b) expressly provides only that the new corporate right it creates may be enforced by the Securities and Exchange Commission (SEC) and security holders of the company.[11]

"Under general rules of law, advisory contracts which are ratified by the shareholders, or in some States approved by a vote of the disinterested directors, may not be upset in the courts except upon a showing of 'corporate waste.' As one court put it, the fee must 'Shock the conscience of the court.' Such a rule may not be an improper one when the protections of arm's-length bargaining are present. But in the mutual fund industry where[] these marketplace forces are not likely to operate as effectively, your committee has decided that the standard of 'corporate waste' is unduly restrictive and recommends that it be changed." S. Rep. No. 91-184, p. 5 (1970).

See *infra*, at 16 and n. 12.

[11] Petitioners argue that, because § 36(b) provides for an action "by a security holder of such registered investment company *on behalf of such company*" (emphasis added), such an action is necessarily derivative. In this regard, petitioners rely on this Court's statement in *Burks* v. *Lasker*, 441 U. S. 471, 477 (1979) that a "derivative suit is brought by shareholders to enforce a claim *on behalf of* the corporation" (emphasis added). See also *id.*, at 484 (referring to actions brought under § 36(b) as "derivative"). The fact that derivative suits are brought on behalf of a corporation does

Petitioners nevertheless contend that an investment company has an implied right of action under § 36(b). In evaluating such a claim, our focus must be on the intent of Congress when it enacted the statute in question. *Merrill Lynch, Pierce, Fenner & Smith* v. *Curran*, 456 U. S. 353, 377–378 (1982). That intent may in turn be discerned by examining a number of factors, including the legislative history and purposes of the statute, the identity of the class for whose particular benefit the statute was passed, the existence of express statutory remedies adequate to serve the legislative purpose, and the traditional role of the states in affording the relief claimed. *Ibid.*; *Middlesex County Sewerage Authority* v. *National Sea Clammers Ass'n*, 453 U. S. 1, 13–15 (1981). *California* v. *Sierra Club*, 451 U. S. 287, 292–293 (1981); *Cannon* v. *University of Chicago*, 441 U. S. 677 (1979); *Cort* v. *Ash*, 422 U. S. 66, 78 (1975). In this case, consideration of each of these factors plainly demonstrates that Congress intended the unique right created by § 36(b) to be enforced solely by the SEC and security holders of the investment company.

As we have previously noted, Congress adopted the Investment Company Act of 1940 because of its concern with

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not mean, however, that all suits brought on behalf of a corporation are derivative. The "on behalf" language in § 36(b) indicates only that the right asserted by a shareholder suing under the statute is a "right of the corporation"—a proposition confirmed by other aspects of the action: The fiduciary duty imposed on advisers by § 36(b) is owed to the company itself as well as its shareholders and any recovery obtained in a § 36(b) action will go to the company rather than the plaintiff. See S. Rep. No. 91-184, p. 6 (1970); § 36(b)(3). In this respect, a § 36(b) action is undeniably "derivative" in the broad sense of that word. See *supra*, at 4. As we have noted, however, Rule 23.1 applies by its terms only to "a derivative action brought by one or more shareholders . . . to enforce a right of a corporation [when] the corporation [has] *failed to enforce a right which may properly be asserted by it*" (emphasis added). The legislative history of § 36(b) makes clear that Congress intended the perhaps unique "right of a corporation" established by § 36(b) to be asserted by the company's security holders and not by the company itself. *Infra*, at 12–17.

"the potential for abuse inherent in the structure of investment companies." *Burks* v. *Lasker*, 441 U. S. 471, 480 (1979). Unlike most corporations, an investment company is typically created and managed by a pre-existing external organization known as an investment adviser. *Id.*, at 481. Because the adviser generally supervises the daily operation of the fund and often selects affiliated persons to serve on the company's board of directors, the "relationship between investment advisers and mutual funds is fraught with potential conflicts of interest." *Ibid.*, *quoting Galfand* v. *Chestnutt Corp.*, 545 F. 2d 807, 808 (CA2 1976). In order to minimize such conflicts of interests, Congress established a scheme that regulates most transactions between investment companies and their advisers, 15 U. S. C. § 80a–17; limits the number of persons affiliated with the adviser who may serve on the fund's board of directors, § 80a–10; and requires that fees for investment advice and other services be governed by a written contract approved both by the directors and the shareholders of the fund, § 80a–15.

In the years following passage of the Act, investment companies enjoyed enormous growth, prompting a number of studies of the effectiveness of the Act in protecting investors. One such report, commissioned by the SEC, found that investment advisers often charged mutual funds higher fees than those charged the advisers' other clients and further determined that the structure of the industry, even as regulated by the Act, had proven resistant to efforts to moderate adviser compensation. Wharton School Study of Mutual Funds, H. R. Rep. No. 2274, 87th Cong., 2d Sess., pp. 28–30, 34, 66–67 (1962). Specifically, the study concluded that the unaffiliated directors mandated by the Act were "of restricted value as an instrument for providing effective representation of mutual fund shareholders in dealings between the fund and its investment adviser." *Id.*, at 34. A subsequent report, authored by the SEC itself, noted that investment advisers were generally compensated on the basis of a fixed percentage of the fund's assets, rather than on services rendered or actual expenses. Securities & Exchange Commission, Public Policy Implications of Investment Company Growth, H. R. Rep. No. 89-2337, p. 89 (1966) (hereinafter SEC Report). The Commission determined that, as a fund's assets grew, this form of payment could produce unreasonable fees in light of the economies of scale realized in managing a larger portfolio. *Id.*, at 94, 102. Furthermore, the Commission concluded that lawsuits by security holders challenging the reasonableness of adviser fees had been largely ineffective due to the standards employed by courts to judge the fees. *Id.*, at 132–143. See *infra*, at 16 and n. 12.

In order to remedy this and other perceived inadequacies in the Act, the SEC submitted a series of legislative proposals to Congress that led to the 1970 Amendments to the Act. Some of the proposals Congress ultimately adopted were intended to make the fund's board of directors more independent of the adviser and to encourage greater scrutiny of adviser contracts. See, *e. g.*, 15 U. S. C. § 80a–10(a) (requiring that at least 40% of the directors not be "interested persons," a broader category than the previously identified group of persons "affiliated" with the adviser, see § 80a–2(a)(19)); § 80a–15(c) (requiring independent directors as well as shareholders to approve adviser contracts); *Burks* v. *Lasker*, *supra*, 441 U. S., at 482–483. The SEC had, however, determined that approval of adviser contracts by shareholders and independent directors could not alone provide complete protection of the interests of security holders with respect to adviser compensation. See SEC Report, *supra*, at 128–131, 144, 146–147. Accordingly, the Commission also proposed amending the Act to require "reasonable" fees. *Id.*, at 143–147. As initially considered by Congress, the bill containing this proposal would have empowered the SEC to bring actions to enforce the reasonableness standard and to intervene in any similar action brought by or on behalf of the company. H. R. 9510, 90th Cong., 1st Sess. § 8(d) (1967); S. 1659, 90th Cong., 1st Sess. § 8(d) (1967).

Representatives of the investment company industry, led by amicus Investment Company Institute (ICI), expressed concern that enabling the SEC to enforce the fairness of adviser fees might in essence provide the Commission with rate-making authority. Accordingly, ICI proposed an alternative to the SEC bill which would have provided that actions to enforce the reasonableness standard "be brought only by the company or a security holder thereof on its behalf." Mutual Fund Legislation of 1967: Hearings on S. 1659 Before the Senate Committee on Banking and Currency, 90th Cong., 1st Sess., Pt. 1, at pp. 100–101 (1967) (hereinafter 1967 Hearings). The version that the Senate finally passed, however, rejected the industry's suggestion that the investment company itself be expressly authorized to bring suit. S. 3724, 90th Cong., 2d Sess. § 8(d)(6) (1968). Instead, the Senate bill required a security holder to make demand on the SEC before bringing suit and provided that, if the Commission refused or failed to bring an action within six months, the security holder could maintain a suit against the adviser in a "derivative" or representative capacity. *Ibid.* Like the original SEC proposal, however, the Senate bill provided that the SEC could intervene in any action brought by the company or by a security holder on its behalf. *Id.*, § 22.

After the bill was reintroduced in the 91st Congress, further hearings and consultations with the industry led to the present version of § 36(b). See S. 2224, 91st Cong., 1st Sess. § 20(b) (1969); 115 Cong. Rec. 13648 (1969) (Statement of Sen. McIntyre). The new version adopted "a different method of testing management compensation." S. Rep. No. 91–184, at p. 5 (1969). Instead of containing a statutory standard of "reasonableness," the new version imposed a "fiduciary duty" on investment advisers. *Id.*, at 5–6. The new bill further provided that "either the SEC or a shareholder may sue in court on a complaint that a mutual fund's management fees involve a breach of fiduciary duty." *Id.*, at 7. The reference in the previous bill to the derivative or representative nature of the security holder action was eliminated, as was the earlier provision for intervention by the SEC in actions brought by the investment company itself. See S. 2224, *supra*, § 22.

In short, Congress rejected a proposal that would have expressly made the statutory standard governing adviser fees enforceable by the investment company itself and adopted in its place a provision containing none of the indications in earlier drafts that the company could bring such a suit. This legislative history strongly suggests that, in adopting § 36(b), Congress did not intend to create an implied right of action in favor of the investment company.

That conclusion is further supported by the purposes of the statute. As noted above, the SEC proposed the predecessor to § 36(b) because of its concern that the structural requirements for investment companies imposed by the Act would not alone ensure reasonable adviser fees. See *supra*, at 14. Indeed, the Commission concluded that the Act's provisions for independent directors and approval of adviser contracts had actually frustrated effective challenges to adviser fees. In particular, the Commission noted that in the three fully litigated cases in which security holders had attacked such fees under state law, the courts had relied on the approval of adviser contracts by security holders or unaffiliated directors to uphold the fees. SEC Report, *supra*, at 132–143.[12] For this

[12] In the three cases cited by the SEC, the courts had evaluated the adviser contracts according to common law standards of corporate waste, under which an unreasonable or unfair fee might be approved unless the court deemed it "unconscionable" or "shocking." SEC Report, *supra*, at 142. See *Acampora* v. *Birkland*, 220 F. Supp. 527, 548–549 (D. Colo. 1963); *Saxe* v. *Brady*, 40 Del. Ch. 474, 486, 184 A. 2d 602, 610 (1962); *Meiselman* v. *Eberstadt*, 39 Del. Ch. 563, 170 A. 2d 720, 723 (1961). Similarly, security holders challenging adviser fees under the Investment Company Act itself had been required to prove gross abuse of trust. See

reason, the Senate Report proposing the final version of the statute noted that, while shareholder and directorial approval of the adviser's contract are entitled to serious consideration by the court in a § 36(b) action, "such consideration would not be controlling in determining whether or not the fee encompassed a breach of fiduciary duty." S. Rep. No. 91–184, at p. 15 (1969); see *id.*, at p. 5. In contrast to its approach in other aspects of the 1970 amendments, then, Congress decided not to rely solely on the fund's directors to assure reasonable adviser fees, notwithstanding the increased disinterestedness of the board. See *Burks* v. *Lasker*, *supra*, 441 U. S., at 481–482 n. 10 and 484. See also SEC Report, *supra*, at 146–148 (right of SEC and security holders to bring actions essential; although role of disinterested directors should be enhanced, "even a requirement that all of the directors of an externally managed investment company be persons unaffiliated with the company's adviser-underwriter would not be an effective check on advisory fees and other forms of management compensation"). This policy choice strongly indicates that Congress intended security holder and SEC actions under § 36(b), on the one hand, and directorial approval of adviser contracts, on the other, to act as independent checks on excessive fees.

Nor do other factors on which we have relied to identify an implied cause of action support petitioners' claim that the right asserted by a shareholder in a § 36(b) action could be enforced by the investment company. First, investment companies, as well as the investing public, are undoubtedly within "the class for whose *especial* benefit" § 36(b) was enacted, *Cort* v. *Ash*, *supra*, 422 U. S., at 78 (emphasis in original), see n. 11, *supra*. Section § 36(b)'s express provision for actions by security holders, however, ensures that, even if the company's directors cannot bring an action in the fund's name, the company's rights under the statute can be fully

Brown v. *Bullock*, 194 F. Supp. 207 (SDNY 1961), *aff'd*, 294 F. 2d 415 (CA2 1961). See 1967 Hearings, *supra*, at 117–118.

vindicated by plaintiffs authorized to act on its behalf. For this reason, it is unnecessary to infer a right of action in favor of the corporation in order to serve the statute's "broad remedial purpose." *Cf., Herman & MacLean* v. *Huddleston*, —— U. S. ——, —— (1983). See also *Middlesex County Sewerage Authority* v. *National Sea Clammers Ass'n.*, *supra*, 453 U. S., at 13–15. Second, because § 36(b) creates an entirely new right, it was obviously not enacted "in a statutory context in which an implied private remedy [had] already been recognized by the courts." *Cf., Merrill Lynch, Pierce, Fenner & Smith* v. *Curran*, *supra*, 456 U. S., at 378; *Herman & MacLean* v. *Huddleston*, *supra*, at ——. Third, a corporation's rights against its directors or third parties with whom it has contracted are generally governed by state, not federal, law. *Burks* v. *Lasker*, *supra*, 441 U. S., at 478. See *Cort* v. *Ash*, *supra*, 422 U. S., at 78.

IV

A shareholder derivative action is an exception to the normal rule that the proper party to bring a suit on behalf of a corporation is the corporation itself, acting through its directors or a majority of its shareholders. Accordingly, Rule 23.1, which establishes procedures designed to prevent minority shareholders from abusing this equitable device, is addressed only to situations in which shareholders seek to enforce a right that "may properly be asserted" by the corporation itself. In contrast, as the language of § 36(b) indicates, Congress intended the fiduciary duty imposed on investment advisers by that statute to be enforced solely by security holders of the investment company and the SEC. It would be anomalous, therefore, to apply a Rule intended to prevent a shareholder from improperly suing in place of the corporation to a statute, like § 36(b), conferring a right which the corporation itself cannot enforce. It follows that Rule 23.1 does not apply to an action brought by a shareholder under § 36(b) of the Investment Company Act and that the plaintiff in such a case need not first make a demand upon the fund's directors before bringing suit.

The judgment of the Court of Appeals is therefore

Affirmed.

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE HARRY A. BLACKMUN

January 4, 1984

Re: No. 82-1200 - Daily Income Fund, Inc. v. Fox

Dear Bill:

Please join me.

Sincerely,

Harry

Justice Brennan

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
THE CHIEF JUSTICE

January 12, 1984

Re: 82-1200 Daily Income Fund, Inc. v. Fox

Dear Bill:

I join.

Regards,

WEB

Mr. Justice Brennan

Copies to the Conference

&82-1200 Income Fund v. Fox (David)

WJB for the Court 11/14/83
1st draft 12/29/83
2nd draft 1/4/84
Joined by LFP 1/3/84
Joined by WJB 1/3/84
Joined by TM 1/3/84
Joined by BRW 1/3/84
Joined by SOC 1/3/84
Joined by HAB 1/4/83
Joined by CJ 1/12/84

JPS concurring in the judgment
1st draft 1/3/84
2nd draft 1/6/84