No. ________

In The
Supreme Court of the United States

DANIELLE SANTOMENNO INDIVIDUALLY AND ON BEHALF OF ANY PERSON OR ENTITY THAT IS A PARTY TO, OR HAS ACQUIRED RIGHTS UNDER, AN INDIVIDUAL OR GROUP VARIABLE ANNUITY CONTRACT THAT WAS ISSUED/SOLD BY JOHN HANCOCK LIFE INSURANCE COMPANY (U.S.A.) WHERE THE UNDERLYING INVESTMENT WAS A JOHN HANCOCK PROPRIETARY FUND CONTAINED IN THE JOHN HANCOCK TRUST,

Petitioner,

v.

JOHN HANCOCK LIFE INSURANCE COMPANY (U.S.A.), JOHN HANCOCK INVESTMENT MANAGEMENT SERVICES, LLC, JOHN HANCOCK FUNDS, LLC, AND JOHN HANCOCK DISTRIBUTORS, LLC,

Respondents.

On Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Third Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Does the decision of the Third Circuit Court of Appeals, that an *explicit* private right of action does not exist under Investment Company Act ("ICA") § 47(b), 15 U.S.C. § 80a-46(b), to enforce violations of ICA § 26(f), 15 U.S.C. § 80a-26(f), conflict with the following opinions of this Court: *Alexander v. Sandoval*, 532 U.S. 275 (2001) (private right of action exists if statute contains a remedy/importance of statutory text); *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11 (1979) (construing similar statute); *Mills v. Electric Auto-Lite*, 396 U.S. 375 (1970) (construing similar statute); *Bd of Trustees of the Leland Stanford Junior Univ. v. Roche Molecular Systems, Inc.*, 131 S.Ct. 2188 (2011) (statutory terms cannot be treated as surplusage); *Sullivan v. Stroop*, 496 U.S. 478 (1990) (interpretation of a statute is based on the plain meaning of statute); *Freeman v. Quicken Loans, Inc.*, 132 S.Ct. 2034 (2012) (same) and *TRW Inc. v. Andrews,* 534 U.S. 19 (2001) (Court must give effect to every clause and word of a statute)?

2. Was it proper for the Third Circuit Court of Appeals to ignore the position of the Securities and Exchange Commission ("SEC") that ICA § 47(b), 15 U.S.C. § 80a-46(b), contains an *explicit* private right of action to enforce violations of ICA § 26(f), 15 U.S.C. § 80a-26(f), ("[t]he Supreme Court precedent makes clear beyond reasonable dispute that private plaintiffs may seek rescission of a contract provision charging excessive fees [under ICA § 47(b), 15 U.S.C. § 80a-46(b)]." *SEC's Amicus Brief* at Appendix p. 78)?

QUESTIONS PRESENTED – Continued

3. Should the Court have followed Seventh Circuit precedent, *Mathers Fund Inc. v. Colwell Co.*, 564 F.2d 780, 783 (7th Cir. 1977), holding that ICA § 47(b), 15 U.S.C. § 80a-46(b), as previously drafted, permits "civil suits for relief," especially in light of the SEC's statement that the 1980 amendments to ICA § 47(b), 15 U.S.C. § 80a-46(b), incorporated into the text of the statute an "express remedy" (*SEC's Amicus Brief* Appendix pp. 70, 80-81, 91)?

LIST OF PARTIES

Danielle Santomenno, individually, and on behalf of any person or entity that is a party to, or has acquired rights under, a variable annuity contract that was issued or sold by John Hancock Life Insurance Company (U.S.A.).*

CORPORATE DISCLOSURE STATEMENT

Petitioner, Danielle Santomenno, is a natural person.

* Danielle Santomenno has advanced a claim under ICA § 47(b), 15 U.S.C. § 80a-46(b). Karen and Barbara Poley, while Plaintiffs in this case, do not advance claims under ICA § 47(b), 15 U.S.C. § 80a-46(b) (but rather under another Federal Statute), and thus are not listed as Petitioners in this petition for Writ of Certiorari. Karen and Barbara Poley are represented by the same counsel that represents Danielle Santomenno.

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The opinion of the United States Court of Appeals for the Third Circuit, for which review is sought, is reported at *Santomenno v. John Hancock Life Ins. Co.*, 677 F.3d 178 (3d Cir. 2012) (Appendix ("App.") pp. 2-24), and was issued on April 16, 2012. On May 15, 2012, the Third Circuit Court of Appeals denied Petitioner's request for a panel and/or *en banc* rehearing. (App. p. 44).

The decision of the Third Circuit Court of Appeals affirmed in part, and reversed in part, a decision of the United States District Court for the District of New Jersey, *Santomenno v. John Hancock Life Ins. Co.*, 2011 WL 2038769, Docket No. 2:10-CV-01655 (D.N.J. May 23, 2011) (App. pp. 28-40).

STATEMENT FOR BASIS OF JURISDICTION

This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1). The Third Circuit Court of Appeals' decision was rendered on April 16, 2012, and Petitioner's request for a panel and/or *en banc* rehearing was denied on May 15, 2012.

RULES INVOLVED IN THE CASE

ICA § 47(b), 15 U.S.C. § 80a-46(b), (reproduced in its entirety in both this petition and accompanying appendix at page 51) and ICA § 26(f), 15 U.S.C. § 80a-26(f), (portion reproduced in this petition and entire statute reproduced in the appendix at pages 45-50).

STATEMENT OF THE CASE

According to the SEC "[v]ariable annuities have become a part of the . . . investment plans of many Americans." (App. p. 93). A "variable annuity places all the investment risks on the annuitant, none on the [insurance] company. The holder gets only a pro rata share of what the portfolio of equity interests reflects-which may be a lot, a little, or nothing." *S.E.C. v. Variable Annuity Life Ins. Co. of Am.*, 359 U.S. 65, 70-71 (1959).

Insurance companies, such as John Hancock Life Insurance Company (U.S.A.) ("JHUSA"), operate variable annuity contracts through "separate account[s]." ICA § 26(f), 15 U.S.C. § 80a-26(f). (*See also* App. p. 100). This case arises out of Petitioner's allegation that she was charged excessive fees on variable annuity contracts funded by JHUSA's separate account.

The JHUSA separate account, at issue here, is divided into several different sub-accounts (App. pp. 96, 100), each of which has its own investment strategy. The investment strategy of each sub-account, however, mimics that of an underlying mutual fund. (App. p. 96). As JHUSA admits, the sole benefit of investing in a sub-account is you are "invest[ing] solely in shares of the specified underlying mutual fund." (App. p. 97).

Despite the fact that the sub-account is largely an accounting construct, the "Expense Ratio" for each sub-account significantly exceeds that of the underlying mutual fund. (App. pp. 96, 103-04). The expenses paid by investors, as JHUSA acknowledges, consist of the sum of "the expenses of the underlying mutual fund" plus JHUSA's "administrative maintenance charge" and "sales and service" fee. (App. p. 96). The SEC's Division of Investment Management has questioned the economic basis of this expense model:

> In many respects, the variable annuity separate account operates much like a mutual fund during the contract's pay in phase. As a result the Division and other commenters have questioned whether variable annuity issuers should be permitted to deduct asset based charges (like risk charges) on a basis that is different from that required of mutual funds.

(App. p. 105).

ICA § 26(f)(2)(A), 15 U.S.C. § 80a-26(f), requires the fees an insurance company charges through its separate account be "reasonable." Petitioner generally contends that the fees that JHUSA charged through its registered separate account, on investments into the sub-accounts, were unreasonable.[1]

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[1] ICA § 36(b), 15 U.S.C. § 80a-35(b), does not provide Petitioner with an adequate remedy because it only addresses, and permits recovery of, excessive fees charged by the underlying mutual fund. *Jones v. Harris Assoc. L.P.*, 130 S.Ct. 1418 (2010).

Petitioner filed suit[2] against JHUSA, asserting rights under ICA § 47(b), 15 U.S.C. § 80a-46(b), which provides that "[a] contract that is made, or whose performance involves, a violation of this title, or of any rule . . . is unenforceable by either party. . . ." The remedies she sought, which are explicitly allowed by ICA §§ 47(b)(2) and (3), 15 U.S.C. §§ 80a-46(b)(2) and (3), are "rescission" of such variable annuity contracts and/or "recovery" against JHUSA for its "unjust enrichment." The Third Circuit Court of Appeals found that Petitioner could not maintain her claim because a private right of action does not exist under ICA § 47(b), 15 U.S.C. § 80a-46(b).

REASONS FOR ALLOWANCE OF THE PETITION

The opinion of the Third Circuit Court of Appeals decided an important federal question – namely, that a private right of action does not exist under ICA § 47(b), 15 U.S.C. § 80a-46(b), which explicitly provides for "rescission at the instance of any party" and recovery for "unjust enrichment." The decision of the Third Circuit Court of Appeals conflicts with the decisions of this Court, the position of the SEC, the Seventh Circuit Court of Appeals, and the plain language of the statute. Therefore, this Court should grant *certiorari* in order to correct this manifest error

[2] The District Court had jurisdiction over Petitioner's claims pursuant to ICA § 44, 15 U.S.C. § 80a-43.

of law, and to make clear that a private right of action exists under ICA § 47(b), 15 U.S.C. § 80a-46(b).

I. Under This Court's Decision In *Alexander v. Sandoval,* 532 U.S. 275 (2001), The Plain Meaning Of ICA § 47(b), 15 U.S.C. § 80a-46(b), Provides For An Explicit Private Right Of Action. The Third Circuit Court Of Appeals Reached A Contrary Conclusion By Inadvertently Ignoring Statutory Text When It Construed ICA § 47(b), 15 U.S.C. § 80a-46(b).

ICA § 26(f)(2), 15 U.S.C. § 80a-26(f)(2), provides that "[i]t shall be unlawful for any registered separate account[3] funding variable insurance contracts, or for the sponsoring insurance company . . . to sell any such contract – (A) unless the fees and charges deducted under the contract, in the aggregate, are reasonable. . . ." Petitioner does not dispute there is no private right of action under ICA § 26(f), 15 U.S.C. § 80a-26(f).

ICA § 47(b), 15 U.S.C. § 80a-46(b), which Petitioner contends contains an explicit private right of action, provides the following:

> (b)(1) A contract that is made, or whose performance involves, a violation of this

[3] "Separate Account" is defined in ICA § 2(a)(37), 15 U.S.C. § 2(a)(37).

title,[4] **or of any rule, regulation, or order thereunder**, is unenforceable by either party (or by a nonparty to the contract who acquired a right under the contract with knowledge of the facts by reason of which the making or performance violated or would violate any provision of this title or of any rule, regulation, or order thereunder) unless a court finds that under the circumstances enforcement would produce a more equitable result than nonenforcement and would not be inconsistent with the purposes of this title.

(2) To the extent that a contract described in paragraph (1) has been performed, **a court may not deny rescission at the instance of any party** unless such court finds that under the circumstances the denial of rescission would produce a more equitable result than its grant and would not be inconsistent with the purposes of this title.

(3) This subsection shall not apply (A) to the lawful portion of a contract to the

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[4] "Westlaw" inaccurately describes the statute as using the word "subchapter;" however, the actual text of ICA § 47(b), 15 U.S.C. § 80a-46(b), uses the word "title." The "Westlaw" version of the statute contains other textual errors. An accurate and actual copy of the entire ICA is available on the SEC's website (which is current as of January 3, 2012) and all quotations to ICA § 47(b), 15 U.S.C. § 80a-46(b) (and any other statutory provision), in Petitioner's Writ of Certiorari, are based on the actual text of the statute. A copy of the actual text of ICA § 47(b), 15 U.S.C. § 80a-46(b), is included in Petitioner's appendix on page 51.

> extent that it may be severed from the unlawful portion of the contract, or (B) to preclude **recovery against any person for unjust enrichment.**

(emphasis added).

Thus, ICA § 47(b)(1), 15 U.S.C. § 80a-46(b)(1), expressly states that "[a] contract . . . whose performance involves, a violation of this title, or of any rule, [or] regulation . . . is unenforceable by either party." The plain meaning of this provision is that a contract that violates ICA § 26(f), 15 U.S.C. § 80a-26(f), (i.e., "this title, or of any rule") is unenforceable by either party. Further, ICA §§ 47(b)(2) and (3), 15 U.S.C. §§ 80a-46(b)(2) and (3), unambiguously provide for the following alternative remedies for contracts that violate the ICA: "a court may not deny **rescission** at the instance of **any party**" or "recovery for **unjust enrichment.**" (emphasis added).

As this Court stated in *Alexander v. Sandoval*, 532 U.S. 275, 286 (2001), in determining whether a statute confers an explicit private right of action:

> Like substantive federal law itself, private rights of action to enforce federal law must be created by Congress. *Touche Ross & Co. v. Redington*, 442 U.S. 560, 578, 99 S.Ct. 2479, 61 L.Ed.2d 82 (1979) (remedies available are those "that Congress enacted into law"). The judicial task is to interpret the statute Congress has passed to determine whether it displays an intent to create not just a private right **but also a private remedy.**

> *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 15, 100 S.Ct. 242, 62 L.Ed.2d 146 (1979). **Statutory intent on this latter point is determinative.** *See, e.g., Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1102, 111 S.Ct. 2749, 115 L.Ed.2d 929 (1991); *Merrell Dow Pharmaceuticals Inc. v. Thompson*, 478 U.S. 804, 812, n. 9, 106 S.Ct. 3229, 92 L.Ed.2d 650 (1986) (collecting cases). **Without it, a cause of action does not exist. . . .**

Id. at 286 (emphasis added).

ICA § 47(b), 15 U.S.C. § 80a-46(b), "displays an intent" by Congress to create a private right of action (i.e., "A contract that is made, or whose performance involves, a violation of this title or of any rule . . . is unenforceable by either party"). Of equal importance, as required by *Sandoval*, the statute contains **remedies**: "rescission" and "unjust enrichment." *See also id.* at 289 ("We therefore begin (and find that we can end) our search for Congress's intent with the text and structure of [the statute].").

The Third Circuit Court of Appeals, it appears, reached its decision that a private right of action does not exist by (A) misreading ICA § 47(b)(1), 15 U.S.C. § 80a-46(b)(1), and (B) not affording significance to the text of ICA §§ 47(b)(2) and (3), 15 U.S.C. §§ 80a-46(b)(2) and (3). In holding that a private right of action does not exist the Court of Appeals quoted the text of ICA § 47(b)(1), 15 U.S.C. § 80a-46(b)(1), to be as follows:

> [a] contract that is made, or whose performance involves a violation of this subchapter[5] . . . is *unenforceable.*

(emphasis in the original). *Santomenno v. John Hancock Life Ins. Co.*, 677 F.3d 178, 187 (3d Cir. 2012).[6] (*See also* App. p. 18). However, the statutory text of this provision does not end after the word "unenforceable," the statute continues by stating "unenforceable by **either party.**" (Bolded text excluded from the Third Circuit's opinion). In addition, ICA § 47(b)(2), 15 U.S.C. § 80a-46(b)(2), specifically provides for the remedy of "rescission" and ICA § 47(b)(3), 15 U.S.C. § 80a-46(b)(3), specifically provides for the remedy of "unjust enrichment." By failing to attach any significance to these terms, the Court of Appeals implicitly treated statutory terms as surplusage. Statutory language should not, however, be treated as surplusage. *See e.g., Bd. of Trustee of Leland Stanford Junior Univ. v. Roche Molecular Sys., Inc.*, 131 S.Ct. 2188, 2196 ("our general 'reluctan[ce] to treat statutory terms as surplusage.") (bracketed text in the original) *quoting Duncan v. Walker*, 533 U.S. 167, 174 (2001).

As the plain meaning of ICA § 47(b), 15 U.S.C. § 80a-46(b), confirms, this statute provides an express

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[5] *See also* n. 4, explaining that the actual statute uses the word "title" as opposed to "subchapter."

[6] In an earlier part of the opinion the Third Circuit Court of Appeals accurately quoted ICA § 47(b)(1), 15 U.S.C. § 80a-46(b)(1), but not in this portion of the opinion.

private right of action; the Third Circuit Court of Appeals decision was in error. *See Sullivan v. Stroop*, 496 U.S. 478, 482 (1990) ("If the statute is clear and unambiguous that is the end of the matter, for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.") *quoting Kmart Corp. v. Cartier, Inc.*, 486 U.S. 281, 291-92 (1988).

II. The Third Circuit Court Of Appeals Erred Because This Court Has Previously Construed Materially Identical Statutes As Providing A Private Right Of Action.

On two prior occasions, this Court held that statutes that are materially identical to ICA § 47(b), 15 U.S.C. § 80a-46(b), provide a private right of action. First, in *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11 (1979), the Supreme Court held that a private right of action existed under a cognate provision of the Investment Advisors Act ("IAA"), § 215, 15 U.S.C. § 80b-15. *Id.* at 19 and 24. That section, similar to ICA § 47(b), 15 U.S.C. § 80a-46(b), provides:

> (b) Every contract made in violation of any provision of this title and every contract heretofore or hereafter made, the performance of which involves the violation of . . .

> this title,[7] or any rule . . . shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, regulation, or order, shall have made or engaged in the performance of any such contract. . . .

In *Transamerica Mortgage Advisors, Inc.*, this Court held that an investor may invoke IAA § 215, 15 U.S.C. § 80b-15, to sue for equitable relief based upon a contract that violated another provision of the IAA, which did not itself provide a cause of action. *Transamerica Mortgage Advisors, Inc.*, 444 U.S. at 19.

Similarly, in *Mills v. Electric Auto-Lite*, 396 U.S. 375, 386-88, nn. 9, 10 (1970), the Supreme Court held that a private right action existed under § 29(b) of the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. § 78cc, which, the Court observed, had

> **counterparts in the . . . Investment Company Act,** . . . as rendering the contract merely voidable at the option of the innocent party. (Citations omitted). This interpretation is eminently sensible. The interests of the victim are sufficiently protected by giving him the right to rescind. . . .

Id. at 387-88 (emphasis added). The ICA counterpart, to which the *Mills* Court cited, was § 47(b), 15 U.S.C. § 80a-46(b), the provision at issue here. *Id.* at 387, n. 10. Since *Mills* recognized that § 29(b) of the 1934

[7] "Westlaw" inaccurately states this statute uses the word "subchapter," however, the actual text of IAA § 215, 15 U.S.C. § 80b-15, uses the word "title."

Act, 15 U.S.C. § 78cc, would allow a suit based upon a violation of a different provision of the Act (one that is silent on rights and remedies), the cognate ICA § 47(b), 15 U.S.C. § 80a-46(b), should be similarly construed.

Cannon v. University of Chicago, 441 U.S. 677 (1979), and *Sandoval*, 532 U.S. 275 (2001), both support Petitioner's position. These cases hold that, if a statutory provision has been construed to allow a private right of action, a similarly worded, subsequently adopted statute should be construed in the same fashion. For example, in *Sandoval*, this Court acknowledged that § 601 of Title VI (which forbids intentional discrimination) contains a private right of action, but held that there is no private right of action to enforce a regulation promulgated under § 602. *Id.* at 279-80. The Court, in summarizing its jurisprudence regarding private rights of action under § 601, explained:

> [P]rivate individuals may sue to enforce § 601 of Title VI . . . In *Cannon v. University of Chicago*, 441 U.S. 677 . . . (1979), the Court held that a private right of action existed to enforce Title IX . . . The reasoning of that decision embraced the existence of a private right to enforce Title VI as well. "Title IX," the Court noted, "was patterned after Title VI" . . . And, "[i]n 1972 when Title IX was enacted, the [parallel] language in Title VI had already been construed as creating a private remedy." . . . That meant, the Court reasoned, that Congress had intended Title

> IX, like Title VI, to provide a private cause of action.

Id. at 279-80 (bracketed text in the original). Thus, if one provision has been construed to create a private right of action, a similarly worded provision should be similarly construed. *Id*. at 280; *See also Cannon*, 441 U.S. at 694-96.

This argument applies with equal force here. Congress amended ICA § 47(b), 15 U.S.C. § 80a-46(b), in 1980, Pub. L. No. 96-477 (1980), after the Supreme Court's decisions in *Mills* and *Transamerica Mortgage Advisors, Inc.* Not only did the 1980 amendments to ICA § 47(b), 15 U.S.C. § 80a-46(b), substantially track IAA § 215, 15 U.S.C. § 80b-15, previously construed to provide a private right of action by the Supreme Court in *Transamerica Mortgage Advisors, Inc.*, 444 U.S. at 19, but the amendments added the additional rights-creating language that (a) "[a] contract that is made, or whose performance involves, a violation of this title, or of any rule . . . is unenforceable by either party"; (b) "a court may not deny rescission at the instance of any party" and (c) nothing shall "preclude recovery against any person for unjust enrichment." *See* ICA §§ 47(b)(1), (2) and (3), 15 U.S.C. §§ 80a-46(b)(1), (2) and (3). As the Supreme Court wrote of similar language in IAA § 215, 15 U.S.C. § 80b-15, this language "necessarily contemplates that [this] issue . . . may be litigated somewhere" by a private party. *Transamerica Mortgage Advisors, Inc.*, 444 U.S. at 18.

In addition, Petitioner's interpretation is consistent with that of the SEC. In *Olmsted v. Pruco Life Ins. Co. of N.J.*, 283 F.3d 429 (2d Cir. 2002), plaintiffs claimed that a direct private right of action existed under ICA § 26(f), 15 U.S.C. § 80a-26(f). The *Olmsted* plaintiffs did not contend that ICA § 47(b), 15 U.S.C. § 80a-46(b), allowed them to sue for a violation of ICA § 26(f), 15 U.S.C. § 80a-26(f). Rather, they only invoked ICA § 26(f), 15 U.S.C. § 80a-26(f). The Second Circuit Court of Appeals, in ruling that a private right of action did not exist under ICA § 26(f), 15 U.S.C. § 80a-26(f), stated:

> The SEC declined to respond to our inquiry regarding §§ 26(f) . . . of the ICA on the grounds that the SEC considers § 47(b) of the ICA . . . to provide a basis for the plaintiffs' claims. Because the plaintiffs make no claim under § 47(b), and because an issue raised only by an *amicus curiae* is normally not considered on appeal . . . we decline to consider the relevance of § 47(b).

Id. at 436, n. 5. Regarding ICA § 47(b), 15 U.S.C. § 80a-46(b), the SEC, in its *amicus* brief, observed:

> Because of the availability and adequacy of the **express Section 47(b) remedy**, it is not necessary for the court to decide whether there also are duplicative implied damage remedies under Sections 26 and 27, and we take no position on this question. In this connection, we do note that the Supreme Court has expressed reluctance to recognize implied rights of action under statutes that

contain express remedies. *See* . . . *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 19-20 (1979). **That reluctance could be particularly pronounced where, as here, there is a rescissionary remedy on the face of the statute that provides adequate express relief [ICA §47(b)] for the alleged harm.**

* * *

The Supreme Court precedent makes clear beyond reasonable dispute that private plaintiffs may seek rescission of a contract provision charging excessive fees.

* * *

A violation of Section 26(f) or 27(i) would clearly give rise to a cause of action under Section 47(b). As noted, those sections make it unlawful for a registered separate account funding variable insurance contracts or a sponsoring insurance company for such account to sell any contract that charges unreasonable fees. Thus, in the language of Section 47(b)(1), a contract containing a provision charging excessive fees would be "made" in violation of the Act, and the "performance" of the contract would "involve[ ]" a violation.

Section 47(b) gives the district courts broad equitable discretion to order the appropriate remedy for violations.

(App. pp. 70-71, 78, 80) (emphasis added).

III. The 1980 Amendments To ICA § 47(b), 15 U.S.C. § 80a-46(b), Replacing The Concept Of "Voidness" With Those Of "Rescission" And "Unenforceability" Were Intended To Fortify Private Rights.

In this case, the Court of Appeals distinguished *Transamerica Mortgage Advisors, Inc.* The Court below reasoned that, because ICA § 47(b), 15 U.S.C. § 80a-46(b), unlike IAA § 215, 15 U.S.C. § 80b-15, does not contain the word "void," the two statutes need not be similarly construed:

> Furthermore, it is not clear that even the *Transamerica* Court would have found a private right of action under Section 47(b) due to the differences in text and structure between the ICA and the IAA. While Section 47(b) of the ICA does track Section 215 of the IAA closely, there are important differences between the two. While the latter states that "[e]very contract made in violation of any provision of this subchapter . . . shall be *void*," 15 U.S.C. § 80b-15(b) (emphasis added), the former stipulates that "[a] contract that is made, or whose performance involves, a violation of this subchapter . . . is *unenforceable.*" 15 U.S.C. § 80a-46(b) (emphasis added). This difference, while seemingly slight, is significant. The Court specifically noted in *Transamerica* that "the legal consequences of voidness are typically not . . . limited [to defensive use]. A person with the power to void a contract ordinarily may

> resort to a court to have the contract rescinded and to obtain restitution of consideration paid." 444 U.S. at 18 (citations omitted). The use of the term "void" in § 215 prompted the Court to conclude that "Congress . . . intended that the customary legal incidents of voidness would follow, including the availability of a suit for rescission or for an injunction against continued operation of the contract, and for restitution." *Id*. at 19, 100 S.Ct. 242.

Santomenno, 677 F.3d at 187 (emphasis and bracketed in the original). *See also* (App. pp. 18-19). Thus, the basis for the Court of Appeals decision, that a private right of action does not exist under ICA § 47(b), 15 U.S.C. § 80a-46(b), was because it believed that: (a) the text of ICA § 47(b)(1), 15 U.S.C. § 80a-46(b)(1), ended after the word "unenforceable" and (b) ICA § 47(b), 15 U.S.C. § 80a-46(b), did not contain a reference to voidness.

As previously discussed, the relevant text of ICA § 47(b)(1), 15 U.S.C. § 80a-46(b)(1), does not conclude with the word "unenforceable," but rather continues to state "unenforceable by either party." Moreover, ICA §§ 47(b)(2) and (3), 15 U.S.C. §§ 80a-46(b)(2) and (3), not mentioned by the Third Circuit Court of Appeals, provide Petitioner with two separate equitable remedies, "rescission" and "unjust enrichment." The right to pursue an unjust enrichment claim can only belong to a private party because neither the SEC nor any other agency would have such a claim.

The excision of the word "void" from ICA § 47(b), 15 U.S.C. § 80a-46(b), which occurred when Congress amended the ICA in 1980, was designed to fortify, not to detract from, the notion that Congress intended to afford a private right of action in ICA § 47(b), 15 U.S.C. § 80a-46(b). Thus, in *Transamerica Mortgage Advisors, Inc.*, the Supreme Court found that an *implied* private right of action existed under IAA § 215, 15 U.S.C. § 80b-15, because the word "void" fairly implied the private remedy of "rescission":

> In the case of § 215, we conclude that **the statutory language itself fairly implies** a right to a specific and limited relief in federal court. By declaring certain contracts void, § 215 by its terms necessarily contemplates that the issue of voidness under its criteria may be litigated somewhere. At the very least Congress must have assumed that § 215 could be raised defensively in private litigation. . . . But the legal consequences are not so limited. **A person with the power to void a contract ordinarily may resort to a court to have the contract rescinded and to obtain restitution of consideration paid.**
>
> * * *
>
> [W]hen Congress declared in § 215 that certain contracts are void, it intended that the customary legal incidents of voidness would follow, including the availability of a suit for rescission. . . .

Transamerica Mortgage Advisors, Inc., 444 U.S. at 18-19 (emphasis added).

The word "rescission" does not appear in the text of IAA § 215. *Id*. at 17, n. 7. It does, however, appear in the text of ICA § 47(b), 15 U.S.C. § 80a-46(b). Specifically, one year after the Supreme Court's decision in *Transamerica Mortgage Advisors, Inc.*, Congress amended ICA § 47(b), 15 U.S.C. § 80a-46(b), to include the following provisions:

> (b)(1) A contract that is made, or whose performance involves, a violation of this title, or of any rule, regulation . . . **is unenforceable by either party**. . . .
>
> (2) To the extent that a contract described in paragraph (1) has been performed, a court may not deny **rescission at the instance of any party** unless such court finds. . . .
>
> (3) This subsection shall not . . . preclude recovery . . . for **unjust enrichment**.

See Investment Company Act, Pub. L. No. 96-477, § 104 (emphasis added) (App. pp. 52-53). *See also* ICA § 47(b), 15 U.S.C. § 80a-46(b).

The replacement of the concept of "voidness" with the remedy inferred by the Supreme Court, "rescission," makes explicit that which was implicit in the IAA. *See also SEC's amicus* brief:

> **Moreover, Congress was aware of *Transamerica* at the time it amended the section in 1980** – the legislative history

> of the bill containing the amendment expressly cites the case in discussing private rights of action. See H.R. 96-1341 at 28 n.6. **Indeed, given the explicit language in Section 47(b)(2) that creates a presumption in favor of rescission, the remedy under the current version of Section 47(b) should be viewed as an express rather than an implied one.**

(emphasis added) (App. pp. 79-80).

Thus, the change to ICA § 47(b), 15 U.S.C. § 80a-46(b), was motivated by Congress' desire to codify an explicit private right of action to bring a complaint for a violation of any provision of the ICA. *See also* H.R. Rep. 96-1341, at *37 (1980) (App. pp. 57-59) (emphasis added):

Section 104 of the Bill replaces the present section 47(b) of the Act in its entirety. . . .

> **The terms of present section 47(b) declare a contract void, as regards to the rights of the violator or non parties to the contract with actual knowledge of its illegality**. . . . **New section 47(b)** stipulates that a contract whose terms **violate the act is unenforceable by either party**. . . . The amended section, however, saves such contracts if a Court finds that enforcement (1) would produce a more equitable result than non-enforcement and (2) would not be inconsistent with the purposes of the Act. . . . The amended section, to a certain extent, **codifies case law under the**

> **present section, and its analogs in other securities laws, by requiring a Court to examine the equities of the situation** and the purposes of the Act in connection with its decision. The amended subsection does not apply (A) to any lawful portion of a contract to the extent it may be severed from an unlawful portion . . . (B) to **preclude recovery for unjust enrichment. These latter provisions enunciate equitable principles upon which interpretation and utilization of the present section have been based.**

IV. ICA § 47(b), 15 U.S.C. § 80a-46(b), Contains Rights Creating Language And A Remedy.

The Third Circuit Court of Appeals found that *Sandoval* was inconsistent with Petitioner's argument because ICA § 26(f), 15 U.S.C. § 80a-26(f), did not, as Petitioner acknowledges, contain rights-creating language. *Santomenno*, 677 F.3d at 186-87 (App. p. 15). However, ICA § 47(b), 15 U.S.C. § 80a-46(b), does contain rights-creating language for violations of "this title." It provides:

> (b)(1) A contract that is made, or whose performance involves, a violation of this title, or of any rule regulation, or order thereunder, **is unenforceable by either party** . . .
>
> (2) To the extent that a contract described in paragraph (1) has been performed, **a court may not deny rescission at the**

> **instance of any party unless such court** . . .
>
> (3) This subsection shall not . . . preclude recovery . . . **for unjust enrichment**.

ICA § 47(b), 15 U.S.C. § 80a-46(b) (emphasis added). Were this section not construed to create rights and remedies on someone's behalf, the whole provision would, impermissibly, be rendered surplusage. *See e.g. TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001). The decision of Congress to grant rights to a "party" must also have some import; for the failure to attribute any meaning to the words "either party" or "party" would render them surplusage. Thus, ICA § 47(b), 15 U.S.C. § 80a-46(b), provides both a private right and a private remedy.

Moreover, ICA § 47(b)(1), 15 U.S.C. § 80a-46(b)(1), focuses on the "individuals protected," *Sandoval*, 532 U.S. at 289, the parties to the contract, on whose behalf a Court may not "deny rescission," and permits "recovery . . . for unjust enrichment" (i.e., remedies). *See* ICA §§ 47(b)(2) and (3), 15 U.S.C. §§ 80a-46(b)(2) and (3). Clearly, these terms, which form the predicate for finding a private right as noted by this Court in *Sandoval,* 532 U.S. at 286, confirm that a private right of action exists under ICA § 47(b), 15 U.S.C. § 80a-46(b), to enforce a violation of another provision of the ICA.

V. ICA § 47(b), 15 U.S.C. § 80a-46(b), Explicitly Provides Relief For A Violation Of "This Title, Or Of Any Rule" (i.e., Any Provision Of The ICA), Not Just ICA § 36(b), 15 U.S.C. § 80a-35(b). The Third Circuit Court Of Appeals Has Impermissibly Rendered ICA § 47(b), 15 U.S.C. § 80a-46(b), A Statutory Nullity.

The Court of Appeals concluded that ICA § 47(b), 15 U.S.C. § 80a-46(b), which expressly states that it may be employed to remedy a violation of "this title, or of any rule, regulation, or order thereunder" (i.e., the ICA), may only be invoked to remedy a violation of ICA § 36(b), 15 U.S.C. § 80a-35(b). Specifically, the Court held:

> Participants misread *Sandoval*, which made it clear that only Congress could create private rights of action. 532 U.S. at 286, 121 S.Ct. 1511 ("Like substantive federal law itself, private rights of action to enforce federal law must be created by Congress."). Congress empowered the Securities and Exchange Commission to enforce all ICA provisions through Section 42 . . . while creating an exclusive private right of action in Section 36(b). In *Sandoval*, the Court observed that "[t]he express provision of one method of enforcing a substantive rule suggests that Congress intended to preclude others. . . ." 532 U.S. at 290, 121 S.Ct. 1511 (citations omitted).

* * *

> As the Court explained, "it is an elemental canon of statutory construction that where a statute expressly provides a particular remedy or remedies, a court must be chary of reading others into it." *Id.* at 19, 100 S.Ct. 242. Thus, one reason why a right of action exists in Section 215 of the IAA but not Section 47(b) of the ICA is because "Congress intended the express right of action set forth in Section 36(b) [of the ICA] to be exclusive; there was no similar exclusive, express right of action in [the IAA]." *Tarlov*, 559 F.Supp. at 438.

Santomenno, 677 F.3d at 186. (*See also* App. pp. 16-17).

This conclusion is incorrect for three reasons. First, it is inconsistent with the plain meaning of ICA § 47(b), 15 U.S.C. § 80a-46(b), which provides that "[a] contract that is made, or whose performance involves, a violation of **this title, or of any rule, regulation, or order thereunder**, is unenforceable by either party" and includes the remedies of "rescission" and "unjust enrichment." *See Freeman v. Quicken Loans, Inc.*, 132 S.Ct. 2034, 2042 (2012) ("In the present statute, the meaning is confirmed by the common sense canon of *noscitur a sociis* – which counsels that a word is given more precise content by the neighboring words with which it is associated.") (internal quotations omitted).

Second, the Court's reasoning is inconsistent with the fact that Section 36(b), 15 U.S.C. § 80a-35(b), was added to the ICA ten years prior to ICA § 47(b), 15 U.S.C. § 80a-46(b), being amended. In 1970, the ICA was amended to include ICA § 36(b), 15 U.S.C. § 80a-35(b) (*see* Pub. L. No. 91-547 (1970) at App. pp. 60-63), which provides mutual fund investors with a private right of action to recover excessive fees charged by the fund ("An action may be brought under this subsection . . . by a security holder. . . .") and a remedy ("any award of damages shall be limited to actual damages. . . ."). *See* ICA § 36(b)(3), 15 U.S.C. § 80a-35(b)(3); *see also Jones v. Harris,* 130 S.Ct. 1418 (2010). Ten years later, in 1980, ICA § 47(b), 15 U.S.C. § 80a-46(b) (*see* Pub. L. No. 96-477 (1980) at App. pp. 52-53), was amended to provide that "[a] contract that is made, or whose performance involves, a violation of **this title, or of any rule** . . . is unenforceable by either party" and to include the remedies of "rescission" and "unjust enrichment." Had Congress intended to limit private standing to suits which allege a violation of ICA § 36(b), 15 U.S.C. § 80a-35(b), only, it would not have used the phrase "title," in defining the scope of actionable provisions. Rather, it would have explicitly referred to ICA § 36(b), 15 U.S.C. § 80a-35(b), or appended the language in ICA § 47(b) to ICA § 36(b). There would simply be no reasons for a separate statutory section. The SEC's position, is consistent with Petitioner's: "[w]e believe, however, that the most appropriate private remedy for a violation of [ICA 26(f)] . . . is the **express remedy** set forth in [amended] Section **47(b) of the ICA, which permits rescission**. . . ." (App. p. 70).

Third, ICA § 36(b), 15 U.S.C. § 80a-35(b), already contains its own provision for a private right of action by a "security holder." Were ICA § 47(b), 15 U.S.C. § 80a-46(b), construed to only create a private right of action under ICA § 36(b), it would serve no purpose. Given that ICA § 47(b), 15 U.S.C. § 80a-46(b), provides that "**a contract that is made, or whose performance involves a violation of this title, or any rule, regulation, or order thereunder**" (emphasis added) may be rescinded at the "instance of any party," and also permits recovery for "unjust enrichment," the Third Circuit Court of Appeals holding that "Congress intended the express right of action set forth in Section 36(b) [of the ICA] to be exclusive,"[8] *Santomenno*, 677 F.3d at 186, (App. p. 17), renders ICA § 47(b), 15 U.S.C. § 80a-46(b), a nullity. A Court should not, however, construe a

[8] In reaching this conclusion, the Third Circuit Court of Appeals relied upon a District Court decision, *Tarlov v. Paine Webber Cashfund, Inc.*, 559 F. Supp. 429 (D. Conn. 1983). Even if it is was correctly decided, *Tarlov* is distinguishable. There, plaintiffs sued for excessive mutual fund fees under ICA § 36(b), 15 U.S.C. § 80a-35(b), and brought a separate additional claim, seeking recovery for the same excessive mutual fund fees encompassed in their ICA § 36(b), 15 U.S.C. § 80a-35(b), claim, under ICA § 47(b), 15 U.S.C. § 80a-46(b). *Id.* at 432. The *Tarlov* plaintiffs brought their ICA § 47(b), 15 U.S.C. § 80a-46(b), claim as an independent claim, rather than as a vehicle to enforce another provision of the ICA or even ICA § 36(b), 15 U.S.C. § 80a-35(b). Moreover, here, Petitioner is seeking recovery of fees she paid to JHUSA, which it charged through its separate account.

statute or the provision of a statute to be meaningless. *See TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001):

> It is "a cardinal principle of statutory construction" that "a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant." *Duncan v. Walker*, 533 U.S. 167, 174, 121 S.Ct. 2120, 150 L.Ed.2d 251 (2001) (internal quotation marks omitted); see *United States v. Menasche*, 348 U.S. 528, 538-539, 75 S.Ct. 513, 99 L.Ed. 615 (1955) ("It is our duty 'to give effect, if possible, to every clause and word of a statute.'" (quoting *Montclair v. Ramsdell*, 107 U.S. 147, 152, 2 S.Ct. 391, 27 L.Ed. 431 (1883))). "[W]ere we to adopt [Andrews'] construction of the statute," the express exception would be rendered "insignificant, if not wholly superfluous." *Duncan*, 533 U.S., at 174, 121 S.Ct. 2120. We are "reluctant to treat statutory terms as surplusage in any setting," *ibid.* (internal alteration and quotation marks omitted), and we decline to do so here.

Id. at 31.

VI. The Third Circuit Court Of Appeals Decision Is Contrary To Public Policy.

The ICA "must be broadly construed in order to insure the investing public a full measure of protection." *Prudential Ins. Co. of Am. v. SEC*, 326 F.2d 383, 386 (3d. Cir. 1964) (*citing S.E.C. v. Capital Gains*

Research Bureau, Inc., 375 U.S. 180 (1963); *S.E.C. v. Ralston Purina Co.*, 346 U.S. 119 (1953); *S.E.C. v. W. J. Howey Co.*, 328 U.S. 293 (1946)).

As noted above, according to the SEC, "[v]ariable annuities have become a part of the . . . investment plans of many Americans." (App. p. 93). Variable annuity contracts are operated through an insurance company's "separate accounts" (separate account is defined in ICA § 2(a)(37), 15 U.S.C. § 80a-2(a)(37)).

ICA § 36(b), 15 U.S.C. § 80a-35(b), regulates the fees that are charged by a mutual fund, *Jones*, 130 S.Ct. at 1424. *In contrast*, ICA § 26(f), 15 U.S.C. § 80a-26(f), regulates the fees charged by an insurance company's separate account. Investors in variable annuities pay the "Underlying [Mutual] Fund Expenses," (i.e., fees which are subject to ICA § 36(b), 15 U.S.C. § 80a-35(b)) *and* also pay fees that are in addition to the underlying mutual fund's expenses, which are assessed by the insurance company's overlaying separate account. (App. p. 95).[9] ICA §§ 26(f)(2) and (3), 15 U.S.C. §§ 80a-26(f)(2) and (3), require that these separate account fees be reasonable.

As ICA § 36(b), 15 U.S.C. § 80a-35(b), only provides investors in variable annuities with standing to

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[9] *See also* App. p. 96, where JHUSA discloses that it charges Petitioner on her investment in a sub-account (division of the separate account) both the fees of the "underlying mutual fund" and additional separate/sub-account fees.

pursue claims with respect to underlying mutual fund expenses, the Third Circuit Court of Appeals ruling that a private right of action does not exist under ICA § 47(b), 15 U.S.C. § 80a-46(b), for violations of ICA § 26(f), 15 U.S.C. § 80a-26(f) (which requires that the separate account fees be reasonable), immunizes separate account fees from challenge. Since investors in variable annuities pay the fees of both the separate account *and* the underlying mutual fund, it makes no sense, given the purpose of the ICA and language of ICA § 47(b), 15 U.S.C. § 80a-46(b), to afford protection of investors against exorbitant mutual fund fees and not afford protection against higher exorbitant separate account fees (which are charged independent of the mutual fund's fees).[10]

The SEC with "a relatively small staff . . . cannot be expected to bring actions against even a large portion of those engaged in schemes. . . . Therefore, private lawsuits serve as an added deterrent to conduct made unlawful by Congress. . . ." H.R. Rep. 96-1341, *28. (App. p. 54). Thus, the Court of Appeals' ruling immunizes insurance companies, who assess exorbitant fees on individual annuities,

[10] While investors in group variable annuities may bring claims for excessive fees charged by the separate account under the Employee Retirement Income Security Act ("ERISA"), investors in individual annuities, are not protected by ERISA and are without recourse. Under ICA § 36(b), 15 U.S.C. § 80a-35(b), investors may only challenge fees charged by the underlying mutual funds.

from investor suits, a result at odds with the purpose of the ICA.[11]

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the Court should grant the petition for write of certiorari.

Respectfully submitted,

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[11] Even if the Court does not agree with the SEC and Petitioner, that an explicit private right of action exists under ICA § 47(b), 15 U.S.C. § 80a-47(b), it should imply one in light of Congress' statement that:

> **The rationale for implying private rights of action under the Securities Laws beyond those actions expressly provided for have been articulated by the Supreme Court. . . .**
>
> * * *
>
> The Committee wishes to make plain that it expects the Courts to imply private rights of action under this legislation, where the plaintiff falls within the class of persons protected by the statutory provisions in question.

H.R. Rep. 96-1341, *28-29 (emphasis added) (App. pp. 55-56).

677 F.3d 178

United States Court of Appeals,
Third Circuit.

Danielle SANTOMENNO, for the use and benefit of the JOHN HANCOCK TRUST and the John Hancock Funds II; Karen Poley and Barbara Poley, for the use and benefit of the John Hancock Funds II; Danielle Santomenno, Karen Poley and Barbara Poley individually and on behalf of Employee Retirement Income Security Act of 1974, as amended ("ERISA"), employee benefit plans that held, or continue to hold, group variable annuity contracts issued/sold by John Hancock Life Insurance Life Insurance [sic] Company (U.S.A.), and Participants and beneficiaries of all such ERISA covered employee benefit plans; and Danielle Santomenno individually and on behalf of any person or entity that is a party to, or has acquired rights under, an individual or group variable annuity contract that was issued/sold by John Hancock Life Insurance Company (U.S.A.) where the underlying investment was a John Hancock proprietary fund contained in the John Hancock Trust,

v.

JOHN HANCOCK LIFE INSURANCE COMPANY (U.S.A.); John Hancock Investment Management Services; John Hancock Funds, LLC; John Hancock Distributors, LLC,
Danielle Santomenno, Karen Poley, Barbara Poley, Appellants.

No. 11-2520.
Argued Feb. 9, 2012.
Opinion Filed: April 16, 2012.

Arnold C. Lakind, Esq. (Argued), Robert L. Lakind, Esq., Szaferman, Lakind, Blumstein & Blader, P.C., Lawrenceville, NJ, for Appellant.

M. Patricia Smith, Solicitor of Labor (Did not enter an appearance), Timothy D. Hauser, Associate Solicitor, Plan Benefits Security Division (Did not enter an appearance), Elizabeth Hopkins, (Did not enter an appearance), for Appellate and Special Litigation.

Robin S. Parry, Esq., Nathaniel I. Spiller, Esq. (Argued), U.S. Department of Labor, Office of the Solicitor, Plan Benefits Security Division, Washington, DC, for Amicus Appellant.

James O. Fleckner, Esq. (Argued), Alison V. Douglass, Esq., Daniel P. Condon, Esq., Goodwin Procter LLP, Boston, MA, Brian J. McMahon, Esq., Gibbons P.C., Newark, NJ, for Appellees.

Before: SLOVITER and VANASKIE, Circuit Judges, and POLLAK,* District Judge.

OPINION OF THE COURT

VANASKIE, Circuit Judge.

Danielle Santomenno, Karen Poley, and Barbara Poley (collectively, "Participants") brought suit against John Hancock Life Insurance Company (U.S.A.) and

* Honorable Louis H. Pollak, Senior Judge of the United States District Court for the Eastern District of Pennsylvania, sitting by designation.

its affiliates (collectively, "John Hancock") under the Employment Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. § 1001 et seq., and the Investment Company Act of 1940 (ICA), 15 U.S.C. § 80a-1 et seq., for allegedly charging their retirement plans excessive fees on annuity insurance contracts offered to plan participants. The District Court granted John Hancock's motion to dismiss. It dismissed the ICA excessive fee claims because only those maintaining an ownership interest in the funds in question could sue under the derivative suit provision enacted by Congress and the Participants are no longer investors in the funds in question. As to the ERISA claims, the District Court found that dismissal was warranted because Participants failed to make a pre-suit demand upon the plan trustees to take appropriate action and failed to join the trustees as parties. We affirm the District Court's judgment with regards to the ICA claims, but vacate and remand on the ERISA counts.

I.

This action arises out of the administration of employer-sponsored 401(k) benefit plans. The trustees of these plans entered into group annuity contracts with John Hancock. Participants brought this action on March 31, 2010. The basis of Participants' complaint is that John Hancock charged a variety of excessive fees in providing investment services to these plans. Santomenno was a security holder in the relevant funds from July 2008 through sometime in

June 2010, K. Poley from July 2004 to sometime in January 2010, and B. Poley from January 2009 to sometime in January 2010. Counts I through VII were brought under Section 502(a) of ERISA, 29 U.S.C. § 1132(a). Count VIII was brought under Section 36(b) of the ICA, 15 U.S.C. § 80a-35(b), and Count IX was brought under Section 47(b) of the ICA, 15 U.S.C. § 80a-46(b).

John Hancock moved to dismiss under FED.R.CIV.P. 12(b)(6). Drawing upon the common law of trusts, the District Court found that all of Participants' theories of liability under ERISA were derivative and dismissed all seven ERISA counts because Participants did not first make demand upon the trustees of the plan and did not join the trustees in the lawsuit. As the District Court explained:

> In short, absent demand, or allegations going to demand futility, or some allegations, which if proven, would establish that the trustees improperly refused to bring suit, it would appear that the beneficiaries of an ERISA plan cannot bring a claim under Section 502. Likewise, any such suit must join the plan's trustees. Here, because there are no such factual allegations and because the trustees have not been joined, dismissal of the ERISA counts, counts I through VII, would seem to be proper.

Santomenno ex rel. John Hancock Trust v. John Hancock Life Ins. Co. (U.S.A.), No. 2-10-cv-01655, 2011 WL 2038769, at *4 (D.N.J. May 23, 2011) (citing

McMahon v. McDowell, 794 F.2d 100, 110 (3d Cir.1986)).

The District Court dismissed Count VIII, brought under section 36(b) of the ICA, because Participants no longer owned any interest in John Hancock funds. The District Court observed that "continuous ownership throughout the pendency of the litigation [is] an element of statutory standing." *Id.* at *5 (citing *Siemers v. Wells Fargo & Co.,* No. C 05-04518WHA, 2007 WL 760750, at *20 (N.D.Cal. Mar. 9, 2007)). The District Court proceeded to dismiss Count IX because, in its view, Section 47(b) of the ICA could only provide relief to Participants if they could "show[ ] a violation of some other section of the Act." *Id.* (quoting *Tarlov v. Paine Webber Cashfund, Inc.,* 559 F.Supp. 429, 438 (D.Conn.1983)). Because Participants' Section 36(b) claim had been dismissed in Count VIII, the District Court reasoned that "the Section 47(b) claim would seem to fail also." *Id.*

II.

The District Court had subject-matter jurisdiction pursuant to Section 502(e) of ERISA, 29 U.S.C. § 1132(e), and Section 44 of the ICA, 15 U.S.C. § 80a-43. We have appellate jurisdiction under 28 U.S.C. § 1291. Our review of an order granting a motion to dismiss is plenary. *Anspach ex rel. Anspach v. City of Phila., Dep't of Pub. Health,* 503 F.3d 256, 260 (3d Cir.2007). When reviewing a Rule 12(b)(6) dismissal, we accept as true all well-pled factual allegations in the complaint, and view them in the light most favorable to the plaintiffs. *Id.*

A.

We begin by addressing the ICA issues. The first question is whether continuous ownership of securities in the fund in question during the pendency of litigation is required for actions brought under Section 36(b) of the ICA. Section 36(b), in pertinent part, provides:

> 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). A suit brought under Section 36(b) is similar to a derivative action in that it is brought on behalf of the investment company. Because the action is brought on behalf of the company, "any recovery obtained in a § 36(b) action will go to the company rather than the plaintiff." *Daily Income Fund, Inc. v. Fox,* 464 U.S. 523, 535 n. 11, 104 S.Ct. 831, 78 L.Ed.2d 645 (1984) (citations omitted). Accordingly, "[i]n this respect, a § 36(b) action is undeniably 'derivative' in the broad sense of that word." *Id.* (citations omitted).

In the context of derivative suits governed by FED.R.CIV.P. 23.1, courts have imposed a requirement of continuous ownership.[1] This requirement:

> [D]erives from the first sentence of Rule 23.1, which refers to actions 'brought by one or more shareholders to enforce a right of a corporation. . . .' The rule's provision that a 'derivative action may not be maintained if it

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[1] FED.R.CIV.P. 23.1(a) provides:

> This rule applies when one or more shareholders or members of a corporation or an unincorporated association bring a derivative action to enforce a right that the corporation or association may properly assert but has failed to enforce. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of shareholders or members who are similarly situated in enforcing the right of the corporation or association.

> appears that the plaintiff does not fairly and adequately represent the interests of the shareholders . . . similarly situated in enforcing the right of the corporation . . . ,' has served as an anchor for the concept that ownership must extend throughout the life of the litigation.

Lewis v. Chiles, 719 F.2d 1044, 1047 n. 1 (9th Cir.1983) (citations omitted).

Section 36(b) plainly requires that a party claiming a breach of the fiduciary duty imposed by that legislative provision be a security holder of the investment company at the time the action is initiated. *See, e.g., Dandorph v. Fahnestock & Co.,* 462 F.Supp. 961, 965 (D.Conn.1979). Imposing a *continuous* ownership requirement throughout the pendency of the litigation assures that the plaintiff will adequately represent the interests of the security holders in obtaining a recovery for the benefit of the company.

Participants assert that "there is no basis upon which to impose a continuing ownership requirement on an ICA § 36(b) claim." (Appellant's Br. at 33.) (citations omitted). Several arguments are advanced in support of Participants' position. First, citing two District Court decisions – *In re American Mutual Funds Fee Litigation,* cv-04-05593, 2009 WL 8099820, at *1 (C.D.Cal. Jul. 14, 2009), and *In re Mutual Funds Investment Litigation,* 519 F.Supp.2d 580, 590 (D.Md.2007) – Participants contend that FED.R.CIV.P. 23.1 does not apply to suits brought under Section 36(b). Participants also attempt to distinguish *Siemers,* 2007 WL

760750, at *20, the primary case relied upon by the District Court in dismissing the ICA section 36(b) claim. Participants assert that "[*Siemers*] is distinguishable because [that] plaintiff did not have an interest in the investment fund when he filed his complaint. Here, Plaintiff Danielle Santomenno did, but the Poleys did not." (Appellant's Br. at 35.) Participants further offer a policy argument: "the imposition of a continuous-ownership requirement would effectively deter a plaintiff, who wishes to mitigate damages by selling his or her investment, from suing – a result at odds with the salutary goals of the ICA." (Appellant's Br. at 35.)

We disagree with Participants' contentions. First, we note that *In re Mutual Funds Investment Litigation,* one of two cases relied upon by Participants, did not concern the continuous ownership question. Instead, the District Court in that case addressed the *contemporaneous* ownership requirement rather than the *continuous* ownership requirement – the idea "that, *at the time of the alleged harm,* plaintiffs must have owned shares in the fund." 519 F.Supp.2d at 590 (emphasis added). There was no question in that case that the plaintiffs continued to hold shares in one of the mutual funds in question.[2]

[2] Notably, the District Court ruled that the plaintiffs did not have standing to assert claims under Section 36(b) on behalf of mutual funds in the same family of funds, *i.e.,* funds sharing a common investment advisor, because Section 36(b) mandates that the plaintiff "be a 'security holder of' the entity on whose

(Continued on following page)

This leaves Participants with *In re American Mutual Funds Fee Litigation*, an opinion that goes against the weight of authority on this topic,[3] and is premised upon an overly expansive reading of the Supreme Court's decision in *Daily Income Fund.* The District Court in *In re American Mutual Funds Fee Litigation* viewed *Daily Income Fund* as dispensing with a continuous ownership standing requirement because such a requirement was recognized in the context of cases arising under Fed.R.Civ.P. 23.1, and that rule does not apply to Section 36(b) claims. *Id.* at

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behalf he seeks to bring suit." 519 F.Supp.2d at 589. Thus, to this extent, the District Court acknowledged the derivative nature of a Section 36(b) claim. *See also Kauffman v. Dreyfus Fund, Inc.,* 434 F.2d 727, 735-36 (3d Cir.1970) (a shareholder of mutual funds who sues on behalf of those funds cannot sue derivatively on behalf of other similarly situated mutual funds because "[s]tanding is justified only by this proprietary interest created by the stockholder relationship and the possible indirect benefits the nominal plaintiff may acquire *qua* stockholder of the corporation which is the real party in interest").

[3] *See, e.g., Siemers,* 2007 WL 760750, at *20 ("For Section 36(b) standing purposes, it is important that the fund be continuously owned during the pendency of the action."); *In re Lord Abbett Mut. Funds Litig.,* 407 F.Supp.2d 616, 633 (D.N.J.2005) (plaintiffs cannot bring a Section 36(b) claim "on behalf of Funds in which they have no ownership interest" because such a claim is derivative, *i.e.,* brought on behalf of the Funds), *partially vacated on other grounds,* 463 F.Supp.2d 505 (D.N.J.2006); *Brever v. Federated Equity Mgmt. Co. of Pa.,* 233 F.R.D. 429, 431 (W.D.Pa.2005) (plaintiff who sold his shares after filing suit "divested himself of standing" to bring suit under Section 36(b)); *In re Franklin Mut. Funds Fee Litig,* 388 F.Supp.2d 451, 468 n. 13 (D.N.J.2005) (plaintiffs may only bring a Section 36(b) claim "against the . . . funds they owned").

*1. *Daily Income Fund,* however, addressed only the pre-suit demand requirement of a common derivative action to which Rule 23.1 applies, *i.e.,* that before bringing suit a shareholder must make demand upon the corporation's directors to take appropriate action with respect to a right "the corporation could itself have enforced in court." 464 U.S. at 529, 104 S.Ct. 831 (citations omitted). Because the right created by Section 36(b) could not be read as one belonging to the company itself, the Court held that there was no basis for imposing a pre-suit demand requirement. *Id.* at 542, 104 S.Ct. 831. *Daily Income Fund* did not address the question of whether a securities holder must maintain that status throughout the pendency of the litigation.

Participants mistakenly assume that the root of the continuous ownership requirement is Rule 23.1. Instead, the prerequisite arises from the fact that Congress directed that only the Securities and Exchange Commission and securities holders, *acting on behalf of the investment company,* could bring an action to enforce the rights created by Section 36(b). As the Court recognized in *Daily Income Fund,* any recovery in an action brought under Section 36(b) belongs to the investment company. 464 U.S. at 535 n. 11, 104 S.Ct. 831. When a plaintiff disposes of his or her holdings in the company, that plaintiff no longer has a stake in the outcome of the litigation because any recovery would inure to the benefit of existing securities holders, not former ones. A continuous ownership requirement gives effect to this "undeniably 'derivative'" nature of a Section 36(b) claim. *Id.* Stated otherwise, a continuous ownership requirement "reflects a shareholder's real interest in obtaining a recovery for the corporation which increases the value of his holdings." *Chiles,* 719 F.2d at 1047 (citing *Lewis v. Knutson,* 699 F.2d 230, 238 (5th Cir.1983); *Schilling v. Belcher,* 582 F.2d 995, 1002 (5th Cir.1978)). As Participants no longer own John Hancock funds, they lack any real interest in securing a recovery.

Participants' policy argument – that a continuous ownership requirement deters a plaintiff from mitigating damages by preventing him or her from selling shares during the pendency of litigation – is unconvincing. First, because the recovery belongs to the company, not the security holder, *see Daily Income Fund,* 464 U.S. at 535 n. 11, 104 S.Ct. 831, it would not seem appropriate to impose a duty to mitigate damages on individual security holders. Moreover, it has long been recognized that only those parties who would actually benefit from a suit may continue to prosecute the action, a rationale that we explicitly adopted in *Kauffman*:

> Standing is justified only by this proprietary interest created by the stockholder relationship and the possible indirect benefits the nominal plaintiff may acquire *qua* stockholder of the corporation which is the real party in interest. Without this relationship,

> there can be no standing, "no right in himself to prosecute this suit."

434 F.2d at 735-36 (citations omitted).

Furthermore, we note that even if continuous ownership were not a requirement of Section 36(b), Participants' claim under that Section still fails. As observed above, a plain reading of Section 36(b) indicates that ownership when the suit is first filed is an indisputable prerequisite. The Poleys' interests in the John Hancock funds were terminated prior to the filing of the original complaint. Therefore, they cannot be classified as "security holder[s]" under Section 36(b). Santomenno, meanwhile, still owned John Hancock funds when the case was first initiated, but no longer had any interest in the funds when the Second Amendment Complaint was filed on October 22, 2010. It is the Second Amended Complaint that is the operative pleading for standing purposes. As the Supreme Court observed in *Rockwell International Corp. v. United States,* 549 U.S. 457, 127 S.Ct. 1397, 167 L.Ed.2d 190 (2007):

> The state of things and the originally alleged state of things are not synonymous; demonstration that the original allegations were false will defeat jurisdiction. So also will the withdrawal of those allegations, unless they are replaced by others that establish jurisdiction. Thus, when a plaintiff files a complaint in federal court and then voluntarily amends the complaint, courts look to the

> amended complaint to determine jurisdiction.

Id. at 473-74, 127 S.Ct. 1397 (citations omitted). Even if we were to hold that continuous ownership is not required by the statute, Participants' Section 36(b) claim would fail because their interests in the John Hancock funds were terminated prior to the filing of the Second Amended Complaint. As a result, they are not security holders entitled to bring an action on behalf of the investment company. Accordingly, dismissal of Participants' Section 36(b) claim was proper.

B.

The second ICA issue is whether Participants' claim under Section 47(b) of the ICA survives a motion to dismiss. Section 47(b), in pertinent part, provides that:

> A contract that is made, or whose performance involves, a violation of [the ICA], or of any rule, regulation, or order thereunder, is unenforceable by either party . . . unless a court finds that under the circumstances enforcement would produce a more equitable result than nonenforcement and would not be inconsistent with the purposes of [the ICA].

15 U.S.C. § 80a-46(b)(1).

Participants argue that the District Court incorrectly dismissed their Section 47(b) claim by erroneously believing it was premised upon a breach of the fiduciary duty provision of Section 36(b) of the ICA. Participants assert that the Section 47(b) claim is not based upon a violation of Section 36(b), but is instead premised upon an alleged violation of Section 26(f) of the ICA, 15 U.S.C. § 80a-26(f), which requires that "the fees and charges deducted under [a registered separate account funding variable insurance contract], in the aggregate, are reasonable in relation to the services rendered, the expenses expected to be incurred, and the risks assumed by the insurance company." 15 U.S.C. § 80a-26(f)(2)(A). While conceding that Section 26(f) does not establish a private cause of action, Participants contend that "its standards are enforceable in an action brought under ICA § 47(b)." (Appellant's Br. at 38.)

Participants contend that because amendments made in 1980 to Section 47(b) "substantially tracked" Section 215 of the Investment Advisers Act of 1940 (IAA), 15 U.S.C. § 80b-15, which had been "previously construed by the Supreme Court [in *Transamerica Mortgage Advisors, Inc. v. Lewis,* 444 U.S. 11, 19, 100 S.Ct. 242, 62 L.Ed.2d 146 (1979)] to provide a right of action," Section 47(b) similarly creates a private right of action in their favor to seek rescission and restitution. (Appellant's Reply Br. at 24.) Citing *Alexander v. Sandoval,* 532 U.S. 275, 121 S.Ct. 1511, 149 L.Ed.2d 517 (2001), Participants contend that the District Court should have read Section 47(b) of the ICA as the Supreme Court read Section 215 of the IAA – as creating a private right of action: "the Court's reasoning . . . that similarly-worded statutes should be similarly construed, especially when the statute at issue was enacted after a provision is judicially construed, supports Plaintiffs' position here." (Appellant's Reply Br. at 24-25.)

Participants misread *Sandoval,* which made it clear that only Congress could create private rights of action. 532 U.S. at 286, 121 S.Ct. 1511 ("Like substantive federal law itself, private rights of action to enforce federal law must be created by Congress."). Congress empowered the Securities and Exchange Commission to enforce all ICA provisions through Section 42, *see* 15 U.S.C. § 80a-41, while creating an exclusive private right of action in Section 36(b). In *Sandoval,* the Court observed that "[t]he express provision of one method of enforcing a substantive rule suggests that Congress intended to preclude others. . . ." 532 U.S. at 290, 121 S.Ct. 1511 (citations omitted).

Unlike Section 36(b) of the ICA, the IAA construed in *Transamerica* did not expressly provide for a private cause of action. *See* 444 U.S. at 14, 100 S.Ct. 242. The *Transamerica* Court observed that where the same statute contains private causes of action in other sections (such as with the ICA), "it is highly improbable that 'Congress absentmindedly forgot to mention an intended private action.'" 444 U.S. at 20, 100 S.Ct. 242 (quoting *Cannon v. University of Chicago,* 441 U.S. 677, 742, 99 S.Ct. 1946, 60 L.Ed.2d 560 (1979) (Powell, J., dissenting)). As the Court explained, "it is an elemental canon of statutory construction that where a statute expressly provides a particular remedy or remedies, a court must be chary of reading others into it." *Id.* at 19, 100 S.Ct. 242. Thus, one reason why a right of action exists in Section 215 of the IAA but not Section 47(b) of the ICA is because "Congress intended the express right of action set forth in Section 36(b) [of the ICA] to be exclusive; there was no similar exclusive, express right of action in [the IAA]." *Tarlov,* 559 F.Supp. at 438.

Another reason not to imply the existence of a cause of action under Section 47(b) to enforce the standards of Section 26(f) of the ICA is that Section 26(f) itself does not create investor rights. Section 26(f) states that "[i]t shall be unlawful for any registered separate account funding variable insurance contracts, or for the sponsoring insurance company of such account, to sell any such contract . . . unless the fees and charges deducted under the contract, in the aggregate, are reasonable." 15 U.S.C. § 80a-26(f)(2). As recognized in *Olmsted v. Pruco Life Insurance Co. of New Jersey,* 283 F.3d 429 (2d Cir.2002), this is not "rights-creating language." *Id.* at 432. The focus of the section is on the insurance company, not on the investors. This focus on the insurance companies rather than the investors is precisely what the Supreme Court meant in *Sandoval* when it observed that "[s]tatutes that focus on the person regulated rather than the individuals protected create 'no implication of an intent to confer rights on a particular class of persons.'" 532 U.S. at 289, 121 S.Ct. 1511 (quoting *California v. Sierra Club,* 451 U.S. 287, 294, 101 S.Ct. 1775, 68 L.Ed.2d 101 (1981)). This led the Second Circuit to conclude in *Olmsted* that "[n]o provision of the ICA explicitly provides for a private right of action for violations of . . . § 26(f) . . . and so we must presume that Congress did not intend one." 283 F.3d at 432.

Furthermore, it is not clear that even the *Transamerica* Court would have found a private right of action in Section 47(b) due to the differences in text and structure between the ICA and the IAA. While Section 47(b) of the ICA does track Section 215 of the IAA closely, there are important differences between the two. While the latter states that "[e]very contract made in violation of any provision of this subchapter . . . shall be *void,*" 15 U.S.C. § 80b-15(b) (emphasis added), the former stipulates that "[a] contract that is made, or whose performance involves, a violation of this subchapter . . . is *unenforceable.*" 15 U.S.C. § 80a-46(b) (emphasis added). This difference, while seemingly slight, is significant. The Court specifically noted in *Transamerica* that "the legal consequences of voidness are typically not . . . limited [to defensive use]. A person with the power to void a contract ordinarily may resort to a court to have the contract rescinded and to obtain restitution of consideration paid." 444 U.S. at 18, 100 S.Ct. 242 (citations omitted). The use of the term "void" in § 215 prompted the Court to conclude that "Congress . . . intended that the customary legal incidents of voidness would follow, including the availability of a suit for rescission or for an injunction against continued operation of the contract, and for restitution." *Id.* at 19, 100 S.Ct. 242.

The use of the term "unenforceable" in Section 47(b), by way of contrast, carries no such legal implications. Indeed, courts have held that the language of Section 47(b) creates "a remedy rather than a distinct cause of action or basis of liability." *Stegall v. Ladner,* 394 F.Supp.2d 358, 378 (D.Mass.2005); *see also Mutchka v. Harris,* 373 F.Supp.2d 1021, 1027 (C.D.Cal.2005).

In summary, neither the language nor the structure of the ICA supports Participants' effort to insinuate their excessive fees claim into Section 47(b). Such a claim is cognizable under Section 36(b), but Participants lack standing to sue under that provision. They cannot circumvent their standing deficiency by resort to Section 47(b). Accordingly, Participants' Section 47(b) claim was properly dismissed.

C.

We now turn to whether pre-suit demand and mandatory joinder of trustees is required for Participants' claims brought under Sections 502(a)(2) and (a)(3) of ERISA. The relevant sections state:

> (a) Persons empowered to bring a civil action
>
> A civil action may be brought – . . .

(2) by the Secretary, or by a participant, beneficiary or fiduciary for appropriate relief under section 1109 of this title;

(3) by a participant, beneficiary, or fiduciary

(A) to enjoin any act or practice which violates any provision of this subchapter or the terms of the plan, or

(B) to obtain other appropriate equitable relief

(i) to redress such violations or

(ii) to enforce any provisions of this subchapter or the terms of the plan.

29 U.S.C. § 1132(a)(2), (a)(3).

The text is silent as to pre-suit demand and mandatory joinder of trustees – in fact, no preconditions on a participant or beneficiary's right to bring a civil action to remedy a fiduciary breach are mentioned at all. This led the Supreme Court to hold in *Harris Trust & Savings Bank v. Salomon Smith Barney, Inc.*, 530 U.S. 238, 120 S.Ct. 2180, 147 L.Ed.2d 187 (2000), that Section 502(a)(3):

> [A]dmits of no limit (aside from the "appropriate equitable relief" caveat) on the universe of possible defendants. Indeed § 502(a)(3) makes no mention at all of which parties may be proper defendants – the focus, instead, is on redressing the "*act or practice* which violates any provision of [ERISA Title

> I].” Other provisions of ERISA, by contrast, expressly address who may be a defendant.

Id. at 239, 120 S.Ct. 2180 (quoting 29 U.S.C. § 1132(a)(3)) (citing 29 U.S.C. § 1109(a)). The text of Sections 502(a)(2) and 502(a)(3) thus does not require joinder of trustees. Furthermore, no Court of Appeals has found pre-suit demand a requirement for civil actions brought under Sections 502(a)(2) or (a)(3). *See, e.g., Katsaros v. Cody,* 744 F.2d 270, 280 (2d Cir.1984) (“[A]lthough common law may have required a prior demand before bringing an action, Congress did not incorporate that doctrine into the ERISA statute. The ERISA jurisdictional statute, 29 U.S.C. § 1132(a)(3), contains no such condition precedent to filing suit.”); *Licensed Div. Dist. No. 1 MEBA/NMU v. Defries,* 943 F.2d 474, 479 (4th Cir.1991) (citing *Katsaros* for the proposition that no prior demand requirement is incorporated into ERISA).

The District Court, relying on *Diduck v. Kaszycki & Sons Contractors, Inc.,* 874 F.2d 912 (2d Cir.1989), and the common law of trusts, held that pre-suit demand upon the trustees and joinder of the trustees as parties were prerequisites to Participants’ ERISA claims. *Diduck,* however, was decided under Section 502(g)(2) of ERISA, 29 U.S.C. § 1132(g)(2), not Sections 502(a)(2) and (a)(3), under which Participants proceed. Indeed, the Second Circuit itself has explained that its holding in *Diduck* is limited to claims brought under Section 502(g)(2), which “authorizes fiduciaries, but no one else, to obtain unpaid contributions pursuant to ERISA § 515, 29 U.S.C. § 1145, which requires employers participating in multi-employer ERISA plans to make obligatory contributions to the plans." *Coan v. Kaufman,* 457 F.3d 250, 258 (2d Cir.2006). As the Second Circuit explained:

> Because section 502(g)(2) only applies to suits by fiduciaries, it is sensible to require plan participants, if they may assert the fiduciaries' right of action at all, to follow Rule 23.1, which applies when the appropriate plaintiff has "failed to enforce a right which may properly be asserted by it." FED.R.CIV.P. 23.1. Section 502(a)(2), unlike section 502(g)(2), provides an express right of action for participants – presumably because the drafters of ERISA did not think fiduciaries could be relied upon to sue themselves for breach of fiduciary duty.

Id.

One reason for this lack of a demand requirement for Section 502(a)(2) and (a)(3) claims is that the protective purposes of ERISA would be subverted if the section covering fiduciary breach required beneficiaries to ask trustees to sue themselves. Accordingly, the District Court erred in concluding that Section 502(g) claims are "akin" to Section 502(a) claims. *Santomenno,* 2011 WL 2038769, at *3. "Because plan participants are expressly authorized to bring suit under section 502(a)(2), the situation here is not controlled by *Diduck.*" *Coan,* 457 F.3d at 258.

In addition to the text, structure, and purpose of ERISA, the legislative history of the statute also indicates that Congress did not intend to impose obstacles such as pre-suit demand or mandatory joinder of trustees with respect to claims brought under Section 502(a):

> The enforcement provisions have been designed specifically to provide both the Secretary [of Labor] and participants and beneficiaries with broad remedies for redressing or preventing violations of the [Act]. . . . The intent of the Committee is to provide the full range of legal and equitable remedies available in both state and federal courts and to remove jurisdictional and procedural obstacles which in the past appear to have hampered effective enforcement of fiduciary responsibilities under state law or recovery of benefits due to participants.

S.REP. NO. 93-127, at 3 (1973), *reprinted in* 1974 U.S.C.C.A.N. 4838, 4871. As we noted in *Leuthner v. Blue Cross & Blue Shield of Northeastern Pennsylvania,* 454 F.3d 120 (3d Cir.2006), "ERISA's legislative history indicates that Congress intended the federal courts to construe the statutory standing requirements broadly in order to facilitate enforcement of its remedial provisions." *Id.* at 128.

In dismissing the ERISA counts, the District Court relied on "guidance from the common law of trusts." *Santomenno,* 2011 WL 2038769, at *3. We believe this reliance was misplaced, as the statute unambiguously allows for beneficiaries or participants to bring suits against fiduciaries without pre-suit demand or joinder of trustees. The common law of trusts is not incorporated en masse into ERISA. On the contrary, "trust law will offer only a starting point, after which courts must go on to ask whether, or to what extent, the language of the statute, its structure, or its purposes require departing from common-law trust requirements." *Varity Corp. v. Howe,* 516 U.S. 489, 497, 116 S.Ct. 1065, 134 L.Ed.2d 130 (1996). As noted above, the language of the statute, the legislative history, and the structure of this remedial legislation compel the conclusion that neither a pre-suit demand requirement nor joinder of the plan trustees is a prerequisite to Participants' claims. Accordingly, the District Court should not have dismissed Counts I through VII due to the lack of a pre-suit demand upon the plan trustees and the absence of the trustees as parties to this action.

III.

For the foregoing reasons, we affirm the District Court's judgment on the ICA counts, but vacate the District Court's dismissal of the ERISA claims and remand for further proceedings.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 11-2520

DANIELLE SANTOMENNO,
for the use and benefit of the John Hancock Trust and the John Hancock Funds II; KAREN POLEY and BARBARA POLEY, for the use and benefit of the John Hancock Funds II; DANIELLE SANTOMENNO, KAREN POLEY and BARBARA POLEY individually and on behalf of Employee Retirement Income Security Act of 1974, as amended ("ERISA"), employee benefit plans that held, or continue to hold, group variable annuity contracts issued/sold by John Hancock Life Insurance Life Insurance [sic] Company (U.S.A.), and the participants and beneficiaries of all such ERISA covered employee benefit plans; and DANIELLE SANTOMENNO individually and on behalf of any person or entity that is a party to, or has acquired rights under, an individual or group variable annuity contract that was issued/sold by John Hancock Life Insurance Company (U.S.A.) where the underlying investment was a John Hancock proprietary fund contained in the John Hancock Trust,

v.

JOHN HANCOCK LIFE INSURANCE COMPANY (U.S.A.); JOHN HANCOCK INVESTMENT MANAGEMENT SERVICES; JOHN HANCOCK FUNDS, LLC; JOHN HANCOCK DISTRIBUTORS, LLC, Danielle Santomenno, Karen Poley, Barbara Poley,

Appellants

On Appeal from the United States District Court
for the District of New Jersey
(D.C. Civil No. 2-10-cv-01655)
District Judge: Honorable William J. Martini

Argued February 9, 2012

Before: SLOVITER and VANASKIE, *Circuit Judges,* and POLLAK,* *District Judge*

JUDGMENT

This cause came on to be considered on the record from the United States District Court for the District of New Jersey and was argued February 9, 2012.

On consideration whereof, it is now hereby ORDERED and ADJUDGED by this Court that the judgment of the District Court entered March 9, 2011 is hereby affirmed in part, vacated in part, and remanded for further proceedings. Costs shall be not

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* Honorable Louis H. Pollak, Senior Judge of the United States District Court for the Eastern District of Pennsylvania, sitting by designation.

be taxed in this matter. All of the above in accordance with the Opinion of this Court.

ATTEST:

/s/Marcia M. Waldron,
Clerk

Dated: April 16, 2012

2011 WL 2038769 (D.N.J.)

United States District Court,
D. New Jersey.
Danielle SANTOMENNO, for the use and benefit of the JOHN HANCOCK TRUST and John Hancock Funds II, et al., Plaintiffs,
v.
JOHN HANCOCK LIFE INS. CO. (U.S.A.), et al., Defendants.

Civil Action No. 2:10-cv-01655.
May 23, 2011.

Arnold Carl Lakind, Robert E. Lytle, Robert Gannon Stevens, Jr., Robert Lawrence Lakind, Szaferman, Lakind, Blumstein, Blader & Lehmann, PC, Robert Gannon Stevens, Jr., Danielle Disporto, Levy Phillips Koningsberg, Lawrenceville, NJ, for Plaintiffs.

Brian J. McMahon, Gibbons, PC, Newark, NJ, for Defendant.

OPINION

WILLIAM J. MARTINI, District Judge.

I. INTRODUCTION

Plaintiffs are beneficiaries or participants in employer-sponsored 401(k) retirement plans. The trustees of these plans made contracts with Defendants to supply a variety of investment services to the plans. The gravamen of the Plaintiffs' Second Amended Complaint is that Defendants purportedly charged the plans excessive fees for investment services.

Counts I through VII are brought under the Employment Retirement Income Security Act (ERISA), 29 U.S.C. § 1001 et seq., and relate to Defendants' operation of their group annuity accounts. Count VIII is brought under Section 36(b) of the Investment Companies Act (ICA), Pub.L. No. 76-768, 54 Stat. 841 (1940), and count IX is brought under Section 47(b) of the ICA. Counts VIII and IX relate to Defendants' operation of both their group and individual annuity accounts. Defendants have moved to dismiss. For the reasons elaborated below, the Court will **GRANT** the motion.

II. FACTUAL BACKGROUND ALLEGED IN THE COMPLAINT

Defendant John Hancock Life Insurance Company (U.S.A.) (JHUSA), a Michigan corporation, operates 401(k) plans through group annuity contracts (GACs). JHUSA establishes a GAC by selecting a menu of investment options or funds. The options may be affiliated with JHUSA or independent of JHUSA. JHUSA provides the menu of options to the employer who then selects a subset of the funds. Generally, the investment options are drawn from three John Hancock Series Trusts (JH Trusts), including: John Hancock Trust (JHT), John Hancock Funds II (JHFII), and John Hancock Funds III (JHFIII). Each trust contains a portfolio of funds. Defendant John Hancock Investment Management Services, LLC (JHIMS), a Delaware limited liability company, provides investment advice to the JH Trusts and to the funds within them. Defendants John Hancock Distributors, LLC (JHD) and John Hancock Funds, LLC (JHF), Delaware limited liability companies and affiliates of JHIMS, make distributions from the JH Trusts' individual funds or portfolios to participants or beneficiaries. Participants in a portfolio offered by JHUSA direct their monies into their own separate sub-accounts, where they are allocated into particular funds within the portfolio. JHUSA charges plan sponsors (a contract level fee) and charges plan participants fees for their investment in the sub-accounts.

Plaintiff Danielle Santomenno invested assets in two JHT Funds: a sub-account of the Money Market Portfolio, and a sub-account of the Small Cap Growth Portfolio. She also invested assets in a single JHFII Fund: a sub-account of the Blue Chip Growth Portfolio. Plaintiff Karen Poley invested assets in a JHFII Fund: a sub-account of the Lifestyle Fund-Balanced Portfolio. Plaintiff Barbara Poley also invested assets in JHFII Funds: a sub-account of the Lifestyle Fund-Balanced Portfolio, a sub-account of the Lifestyle Fund-Aggressive Portfolio, and a sub-account of the Lifestyle Fund-Growth Portfolio.

Count I alleges that Defendant JHUSA's sales and service is excessive and in violation of ERISA. In regard to Count I, the purchased funds are John Hancock funds. Count II differs from Count I in that the funds purchased are independent funds.

Counts III alleges that Defendants JHUSA, JHIMS, JHD, and JHF allowed payment of 12b1 fees in violation of ERISA. Count IV makes a similar allegation, but here the 12b-1 fees were tied to independent funds.

Count V alleges that JHUSA wrongfully allowed JHIMS to charge Plaintiffs an advisory fee in violation of ERISA.

Count VI alleges that JHUSA wrongfully received revenue sharing payments from Plaintiffs' investments into sub-accounts in violation of ERISA.

Count VII alleges that JHUSA wrongfully selected JHT Money Market Trust as an investment option notwithstanding poor performance, high fees, and wrongfully retained JHIMS as an advisor, notwithstanding that it had been disciplined by the SEC, all purportedly in violation of ERISA. In regard to Counts I through VII, Plaintiffs assert that the Defendants were ERISA fiduciaries (or otherwise knowingly participated in a breach of duty by a fiduciary).

Count VIII seeks recovery of purportedly excessive investment management fees charged by JHIMS under ICA § 36(b). Count IX seeks relief for unjust enrichment and rescission under ICA § 47(b).

III. STANDARD OF REVIEW

The Defendants' motion to dismiss is brought pursuant to the provisions of Federal Rule of Civil

Procedure 12(b)(6). This rule provides for the dismissal of a complaint, in whole or in part, if the plaintiff fails to state a claim upon which relief can be granted. The moving party bears the burden of showing that no claim has been stated, *Hedges v. United States*, 404 F.3d 744, 750 (3d Cir.2005), and dismissal is appropriate only if, accepting all of the facts alleged in the complaint as true, the plaintiff has failed to plead "enough facts to state a claim to relief that is plausible on its face," *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007) (abrogating "no set of facts" language found in *Conley v. Gibson*, 355 U.S. 41, 45-46, 78 S.Ct. 99, 2 L.Ed.2d 80 (1957)). The facts alleged must be sufficient to "raise a right to relief above the speculative level." *Twombly*, 550 U.S. at 555. This requirement "calls for enough fact[s] to raise a reasonable expectation that discovery will reveal evidence of" necessary elements of the plaintiff's cause of action. *Id*. Furthermore, in order to satisfy federal pleading requirements, the plaintiff must "provide the grounds of his entitlement to relief," which "requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do." *Phillips v. County of Allegheny*, 515 F.3d 224, 231 (3d Cir.2008) (quoting *Twombly*, 550 U.S. at 555).

IV. ANALYSIS

The nine-count complaint alleges liability under ERISA and the ICA. Each theory of liability is discussed in turn.

A. COUNTS I THROUGH 7: THE ERISA THEORIES OF LIABILITY

Defendants argue that Plaintiffs' ERISA counts are derivative. That is, these claims belong to the plans and Plaintiffs as plan participants or beneficiaries are asserting claims which belong to the plan and, should relief be granted, the relief would be awarded to the plan. *See* ERISA § 502(a)(2), 29 U.S.C. § 1132(a)(2) ("A civil action may be brought – by the Secretary, or by a participant, beneficiary or fiduciary for appropriate relief under section 1109 of this title"); *LaRue v. DeWolff, Boberg & Assocs., Inc.*, 552 U.S. 248, 253, 128 S.Ct. 1020, 169 L.Ed.2d 847 (2008) (authorizing "plan participants [and] beneficiaries . . . to bring actions on behalf of a plan"). Defendants argue that in such circumstances, Plaintiffs, before bringing the derivative claim, must first make demand upon the trustees of the plan. Apparently no such demand has been made, nor are the trustees listed as defendants in this action. Plaintiffs take the position that ERISA's statutory language nowhere expressly requires demand on a plan's trustees, although it otherwise authorizes suit by a plan's beneficiaries. Furthermore, Plaintiffs point to persuasive authority where courts in other circuits have rejected imposing pre-suit demand grounded in application of Federal Rule of Civil Procedure 23.1.

The Third Circuit has not spoken to this precise question. *Struble v. N.J. Brewery Employees' Welfare Trust Fund*, 732 F.2d 325, 338 (3d Cir.1984) ("We are not called upon to decide at this time whether beneficiaries in the present type of derivative action are required to make a 'demand' on the Trustees to bring suit in the name of the Trust Fund or whether, if such demand is generally required, it should be excused [as futile] in the present circumstances."), *overturned on other grounds Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 109 S.Ct. 948, 103 L.Ed.2d 80 (1989). The Second Circuit has held that in relation to an ERISA § 502(g) claim, which is akin to the Section 502(a) claims here, "[a] participant in a fund governed by ERISA can sue derivatively on behalf of the fund only if the plaintiff first establishes that the *trustees* breached their fiduciary duty." *Diduck v. Kaszycki & Sons Contractors, Inc.*, 874 F.2d 912, 916 (2d Cir.1989) (emphasis added). Arguably, this would seem to preclude suit here – because Plaintiffs' complaint makes no allegations against the Plans' trustees. More importantly, *Diduck* was applying the well-known rule mandating demand on the trustees, except when such demand is futile. Again, this would seem to preclude suit here: Plaintiffs have made no allegations against the trustees (as opposed to the named Defendants who Plaintiffs allege to be non-trustee fiduciaries) suggesting that they (the trustees) violated any fiduciary duty or that demand is otherwise futile. Judge Van Graafeiland was more explicit:

> Because the right to sue for promised [ERISA] contributions belongs to the trustees, fund participants such as Diduck cannot exercise the right derivatively without first giving the trustees the opportunity to

> compel payment. . . . Before a participant such as Diduck can sue an employer for promised fund contributions, he must show either that he made a demand upon the trustees for suit or that such a demand would have been futile.
>
> *Id*. at 923 (Van Graafeiland, J., dissenting).

To the extent that gap filling the meaning of the ERISA statute is a matter of federal common law, it would appear to follow the common law of trusts. Indeed, in expounding on ERISA law, courts often seek guidance from the common law of trusts. *See, e.g., LaRue*, 552 U .S. [sic] at 253 n. 4; *Zavolta v. Lord, Abbett & Co. LLC*, 2010 WL 686546, at *5 (D.N.J. Feb.24, 2010) (same). "Ordinarily the *trustee*, and he alone, is permitted to sue the wrongdoer." GEORGE T. BOGERT, TRUSTS 610 (6th ed.1987) (emphasis added); RESTATEMENT (SECOND) OF TRUSTSS [sic] § 282 cmt. a (1959) ("As long as the trustee is ready and willing to take the proper proceedings against . . . third persons [who wrong the trust], the beneficiary cannot maintain a suit in equity against [third parties]."). The broad language of these authorities – using "wrongdoer" and "third persons" – would seem to extend to JHUSA and to the other John Hancock defendants, even if they are, as alleged by Plaintiff, non-trustee fiduciaries vis-à-vis the ERISA plans.

Alternatively, to the extent that gap filling the meaning of the ERISA is a matter of substantive state law, one would turn to the choice of law provision of the plan or the law under which the plan was organized (assuming it is formally organized). *Cf. Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 97, 111 S.Ct. 1711, 114 L.Ed.2d 152 (1991) (holding that contours of the demand requirement under the ICA follow state law in which the entity was organized). Although, the plans at issue here have not been filed as exhibits, the Court is aware of no state which does not impose a demand requirement. Generally, the variations in state law in regard to the demand requirement go not to the existence of the demand requirement, but to the extent, if any, of the futility exception to the demand requirement. *See, e.g., Va. M. Damon Trust v. N. Country Fin. Corp.*, 325 F.Supp.2d 817, 821 (W.D.Mich.2004) ("Michigan has adopted a universal demand rule, mandating pre-suit demand upon the corporation in all circumstances and providing no possibility for circumvention of this rule by assertions of futility. . . ."); *Lola Cars Int'l Ltd. v. Krohn Racing, LLC*, 2009 WL 4052681, at *7 (Del.Ch. Nov.12, 2009) ("Because [plaintiff] did not make a demand upon [the limited liability company's] board, the inquiry then turns to whether it alleged demand excusal with particularity.").

If demand on the Plans' trustees in this case were futile, then there would be some reason to consider excusing demand. But here, the complaint fails to name the plans' trustees, fails to make well-pled allegations as to whether they joined in the alleged fiduciary breaches by the named Defendants, and fails to join the trustees as defendants. Even assuming that demand on the trustees is not required, the Third Circuit has required such trustee-related factual allegations. "Under traditional trust law doctrine, *incorporated into ERISA*, if a trustee holds in trust a . . . right against a third person and the trustee *improperly* refuses to bring an action to enforce the [right], the beneficiaries can maintain a suit . . . against the *trustee* joining the [third person] as co-defendant." *McMahon v. McDowell*, 794 F.2d 100, 110 (3d Cir.1986) (emphasis added). In short, absent demand, or allegations going to demand futility, or some allegations, which if proven, would establish that the trustees improperly refused to bring suit, it would appear that the beneficiaries of an ERISA plan cannot bring a claim under Section 502. Likewise, any such suit must join the plan's trustees. *McMahon*, 794 F.2d at 110. Here, because there are no such factual allegations and because the trustees have not been joined, dismissal of the ERISA counts, counts I through VII, would seem to be proper.

B. COUNT VIII: THE INVESTMENT COMPANIES ACT SECTION 36(b) CLAIM

ICA § 36(b), 15 U.S.C. § 80a-35(b), authorizes an "action . . . under this subsection by the Commission, or by a security holder of such registered investment company on *behalf of such company*." Because such a suit is brought upon behalf of the company, it can be broadly characterized as derivative. *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 535, 104 S.Ct. 831, 78 L.Ed.2d 645 (1984). Following both the statutory language and the well-known rule in derivative actions requiring continuous ownership of stock as a precondition of suit, other courts have dismissed Section 36(b) claims where the plaintiff, although holding stock at the commencement of the action, no longer holds stock at some point thereafter during the pendency of the suit. *See, e.g., Siemers v. Wells Fargo & Co.*, 2007 WL 760750, at *20 (N.D.Cal. Mar.9, 2007) ("For Section 36(b) standing purposes, it is important that the fund be continuously owned during the pendency of the action.").

Plaintiffs' position is that Section 36(b) standing exists if a plaintiff is a security holder merely at the time suit is filed, even if the plaintiff loses his security holder status during the pendency of the litigation. However, because "*any* recovery obtained in a § 36(b) action will go to the company rather than the plaintiff," *Daily Income Fund*, 464 U.S. at 535 n. 11 (emphasis added), a former security holder would have no concrete interest in the outcome of the litigation. *Bender v. Williamsport Area School Dist.*, 475 U.S. 534, 543-544, 106 S.Ct. 1326, 89 L.Ed.2d 501 (1986) (school board member who "has no personal stake in the outcome of the litigation" has no standing). It would seem to follow that a former security holder – where all sought after relief flows to the entity – would seem to lack Article III standing. *Cf. Lewis v. Chiles*, 719 F.2d 1044, 1047 (9th Cir.1983) ("[A]s a practical matter, the continuous ownership requirement stems from the equitable nature of derivative litigation which allows a shareholder to step into the corporation's shoes and to seek in its right the restitution he could not demand in his own. This equitable principle reflects a *shareholder's real interest in obtaining a recovery for the corporation which increases the value of his holdings*." (emphasis added)). This strongly counsels in favor of interpreting the statutory standing provisions of the Investment Companies Act along the lines suggested by the *Siemers* court, and, therefore, requiring continuous ownership throughout the pendency of the litigation as an element of statutory standing. *See Siemers*, 2007 WL 760750, at *20. *But see* In re *Am. Mut. Funds Fee Litig.*, 2009 WL 8099820, at *1 (C.D.Cal. July 14, 2009) (rejecting the *Siemers* position, but failing to consider the implications for Article III standing).

It is not contested that the contracts between the Plans' trustees and the Defendants have been terminated. *I.e.*, Plaintiffs do not currently own any interests in the Defendants' funds. In these circumstances it would appear that the Section 36(b) claim must be dismissed.

C. COUNT IX: THE INVESTMENT COMPANIES ACT SECTION 47(b) CLAIM

Count IX is brought pursuant to ICA § 47(b). *See* Plts.' Br. 50 ("Plaintiffs are not suing under ICA § 26."). "A plaintiff can seek relief under Section 47 only by showing a violation of some other section of the Act." *Tarlov v. Paine Webber Cashfund, Inc.*, 559

F.Supp. 429, 438 (D.Conn. 1983); *Hamilton v. Allen*, 396 F.Supp.2d 545, 558-59 (E.D.Pa.2005) ("Moreover, to the extent Plaintiffs' other Investment Company Act claims fail, their Section 47(b) claim must necessarily fail because a violation of the Act is a predicate to the remedy provided therein. A plaintiff asserting a claim under the Investment Company Act may seek relief under Section 47 only after a violation of some other section of the Act has been established."). Because this Court has already dismissed Plaintiffs' Section 36(b) claim, the only other cause of action under the ICA, the Section 47(b) claim would seem to fail also.

V. CONCLUSION

For the reasons elaborated above, the Court **GRANTS** Defendants' motion to dismiss. This terminates this action.

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

DANIELLE SANTOMENNO, ***for the use and benefit of the John Hancock Trust and John Hancock Funds II, et al.,*** **Plaintiffs,** **v.** **JOHN HANCOCK LIFE INS. CO. (U.S.A.),** ***et al.,*** **Defendants.**	**Civil Action Number: 2:10-cv-01655** **ORDER** **HON. WILLIAM J. MARTINI**

ORDER

For the reasons elaborated in the opinion filed contemporaneously with this order,

IT IS on this 23th day of May 2011, hereby,

ORDERED that Defendants' Motion to Dismiss the Second Amended Complaint is **GRANTED**;

and,

ORDERED that this terminates this action.

s/ William J. Martini
William J. Martini, U.S.D.J.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 11-2520

DANIELLE SANTOMENNO,
for the use and benefit of the John Hancock Trust and the John Hancock Funds II; KAREN POLEY and BARBARA POLEY, for the use and benefit of the John Hancock Funds II; DANIELLE SANTOMENNO, KAREN POLEY and BARBARA POLEY individually and on behalf of Employee Retirement Income Security Act of 1974, as amended ("ERISA"), employee benefit plans that held, or continue to hold, group variable annuity contracts issued/sold by John Hancock Life Insurance Life Insurance [sic] Company (U.S.A.), and Participants and beneficiaries of all such ERISA covered employee benefit plans; and DANIELLE SANTOMENNO individually and on behalf of any person or entity that is a party to, or has acquired rights under, an individual or group variable annuity contract that was issued/sold by John Hancock Life Insurance Company (U.S.A.) where the underlying investment was a John Hancock proprietary fund contained in the John Hancock Trust,

v.

JOHN HANCOCK LIFE INSURANCE COMPANY (U.S.A.); JOHN HANCOCK INVESTMENT MANAGEMENT SERVICES; JOHN HANCOCK FUNDS,

LLC; JOHN HANCOCK DISTRIBUTORS, LLC,
Danielle Santomenno, Karen Poley, Barbara Poley,

Participants

On Appeal from the United States District Court
for the District of New Jersey
(D.C. Civil No. 2-10-cv-01655)
District Judge: Honorable William J. Martini

SUR PETITION FOR REHEARING WITH
SUGGESTION FOR REHEARING EN BANC

Present: MCKEE, *Chief Judge,* SLOVITER,
SCIRICA, RENDELL, AMBRO, FUENTES, SMITH,
FISHER, CHAGARES, JORDAN, HARDIMAN,
GREENAWAY, JR. and VANASKIE, *Circuit Judges,*
and POLLAK, *District Judge**

The petition for rehearing filed by Appellants having been submitted to the judges who participated in the decision of this Court and to all the other available circuit judges in regular active service, and no judge who concurred in the decision having asked for a rehearing, and a majority of the circuit judges of

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* The petition for rehearing was submitted to the Honorable Louis H. Pollak, Senior District Judge for the United States District Court for the Eastern District of Pennsylvania, sitting by designation, who passed away prior to the entry of this order.

the circuit in regular active service not having voted for rehearing by the Court en banc, the petition for rehearing by the panel and the Court en banc is DENIED.

BY THE COURT:

/s/ Thomas I. Vanaskie
Circuit Judge

Dated: May 15, 2012
PDB/cc: All Counsel of Record

INVESTMENT COMPANY ACT OF 1940

UNIT INVESTMENT TRUSTS

SEC. 26. (a) No principal underwriter for or depositor of a registered unit investment trust shall sell, except by surrender to the trustee for redemption, any security of which such trust is the issuer (other than short-term paper), unless the trust indenture, agreement of custodianship, or other instrument pursuant to which such security is issued –

(1) designates one or more trustees or custodians, each of which is a bank, and provides that each such trustee or custodian shall have at all times an aggregate capital, surplus, and undivided profits of a specified minimum amount, which shall not be less than $500,000 (but may also provide, if such trustee or custodian publishes reports of condition at least annually, pursuant to law or to the requirements of its supervising or examining authority, that for the purposes of this paragraph the aggregate capital, surplus, and undivided profits of such trustee or custodian shall be deemed to be its aggregate capital, surplus, and undivided profits as set forth in its most recent report of condition so published);

(2) provides, in substance, (A) that during the life of the trust the trustee or custodian, if not otherwise remunerated, may charge against and collect from the income of the trust, and from the corpus thereof if no income is available, such fees for its services and such reimbursement for its expenses as are provided for in such

instrument; (B) that no such charge or collection shall be made except for services theretofore performed or expenses theretofore incurred; (C) that no payment to the depositor of or a principal underwriter for such trust, or to any affiliated person or agent of such depositor or underwriter, shall be allowed the trustee or custodian as an expense (except that provision may be made for the payment to any such person of a fee, not exceeding such reasonable amount as the Commission may prescribe as compensation for performing bookkeeping and other administrative services, of a character normally performed by the trustee or custodian itself); and (D) that the trustee or custodian shall have possession of all securities and other property in which the funds of the trust are invested, all funds held for such investment, all equalization, redemption, and other special funds of the trust, and all income upon, accretions to, and proceeds of such property and funds, and shall segregate and hold the same in trust (subject only to the charges and collections allowed under clauses (A), (B), and (C)) until distribution thereof to the security holders of the trust;

(3) provides, in substance, that the trustee or custodian shall not resign until either (A) the trust has been completely liquidated and the proceeds of the liquidation distributed to the security holders of the trust, or (B) a successor trustee or custodian, having the qualifications prescribed in paragraph (1), has been designated and has accepted such trusteeship or custodianship; and

(4) provides, in substance, (A) that a record will be kept by the depositor or an agent of the depositor of the name and address of, and the shares issued by the trust and held by, every holder of any security issued pursuant to such instrument, insofar as such information is known to the depositor or agent; and (B) that whenever a security is deposited with the trustee in substitution for any security in which such security holder has an undivided interest, the depositor or the agent of the depositor will, within five days after such substitution, either deliver or mail to such security holder a notice of substitution, including an identification of the securities eliminated and the securities substituted, and a specification of the shares of such security holder affected by the substitution.

(b) The Commission may, after consultation with and taking into consideration the views of the Federal banking agencies (as defined in section 3 of the Federal Deposit Insurance Act), adopt rules and regulations, and issue orders, consistent with the protection of investors, prescribing the conditions under which a bank, or an affiliated person of a bank, either of which is an affiliated person of a principal underwriter for, or depositor of, a registered unit investment trust, may serve as trustee or custodian under subsection (a)(1).

(c) It shall be unlawful for any depositor or trustee of a registered unit investment trust holding the security of a single issuer to substitute another security for such security unless the Commission shall have approved such substitution. The Commission shall issue an order approving such substitution if the evidence establishes that it is consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this title.

(d) In the event that a trust indenture, agreement of custodianship, or other instrument pursuant to which securities of a registered unit investment trust are issued does not comply with the requirements of subsection (a) of this section, such instrument will be deemed to meet such requirements if a written contract or agreement binding on the parties and embodying such requirements has been executed by the depositor on the one part and the trustee or custodian on the other part, and three copies of such contract or agreement have been filed with the Commission.

(e) Whenever the Commission has reason to believe that a unit investment trust is inactive and that its liquidation is in the interest of the security holders of such trust, the Commission may file a complaint seeking the liquidation of such trust in the district court of the United States in any district wherein any trustee of such trust resides or has its principal place of business. A copy of such complaint shall be served on every trustee of such trust, and notice of the proceeding shall be given such other interested persons in such manner and at such times as the court may direct. If the court determines that such liquidation is in the interest of the security holders of such trust, the court shall order such liquidation and, after payment of necessary expenses, the distribution of the proceeds to the security holders of the trust in such manner and on such terms as may to the court appear equitable.

(f) EXEMPTION. –

(1) IN GENERAL. – Subsection (a) does not apply to any registered separate account funding variable insurance contracts, or to the sponsoring insurance company and principal underwriter of such account.

(2) LIMITATION ON SALES. – It shall be unlawful for any registered separate account funding variable insurance contracts, or for the sponsoring insurance company of such account, to sell any such contract –

(A) unless the fees and charges deducted under the contract, in the aggregate, are reasonable in relation to the services rendered, the expenses expected to be incurred, and the risks assumed by the insurance company, and, beginning on the earlier of August 1, 1997, or the earliest effective date of any registration statement or amendment thereto for such contract following the date of enactment of this subsection, the insurance company so represents in the registration statement for the contract; and

(B) unless the insurance company –

(i) complies with all other applicable provisions of this section, as if it were a trustee or custodian of the registered separate account;

(ii) files with the insurance regulatory authority of the State which is the domiciliary State of the insurance company, an annual statement of its financial condition, which most recent statement indicates that the insurance company has a combined capital and surplus, if a stock company, or an unassigned surplus, if a mutual company, of not less than $1,000,000, or such other amount as the Commission may from time to time prescribe by rule, as necessary or appropriate in the public interest or for the protection of investors; and

(iii) together with its registered separate accounts, is supervised and examined periodically by the insurance authority of such State.

(3) FEES AND CHARGES. – For purposes of paragraph (2), the fees and charges deducted under the contract shall include all fees and charges imposed for any purpose and in any manner.

(4) REGULATORY AUTHORITY. – The Commission may issue such rules and regulations to carry out paragraph (2)(A) as it determines are necessary or appropriate in the public interest or for the protection of investors.

*   *   *

VALIDITY OF CONTRACTS

SEC. 47. (a) Any condition, stipulation, or provision binding any person to waive compliance with any provision of this title or with any rule, regulation, or order thereunder shall be void.

(b)(1) A contract that is made, or whose performance involves, a violation of this title, or of any rule, regulation, or order thereunder, is unenforceable by either party (or by a nonparty to the contract who acquired a right under the contract with knowledge of the facts by reason of which the making or performance violated or would violate any provision of this title or of any rule, regulation, or order thereunder) unless a court finds that under the circumstances enforcement would produce a more equitable result than nonenforcement and would not be inconsistent with the purposes of this title.

(2) To the extent that a contract described in paragraph (1) has been performed, a court may not deny rescission at the instance of any party unless such court finds that under the circumstances the denial of rescission would produce a more equitable result than its grant and would not be inconsistent with the purposes of this title.

(3) This subsection shall not apply (A) to the lawful portion of a contract to the extent that it may be severed from the unlawful portion of the contract, or (B) to preclude recovery against any person for unjust enrichment.

PL 96-477 (HR 7554)
OCTOBER 21, 1980

An Act to amend the Federal securities laws to provide incentives for small business investment, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act // 15 USC 80a-51 // may be cited as the "Small Business Investment Incentive Act of 1980".

TITLE I – AMENDMENTS TO THE INVESTMENT COMPANY ACT OF 1940
DEFINITIONS

VALIDITY OF CONTRACTS

Sec. 104. Section 47(b) of the Investment Company Act of 1940 (15 U.S.C. 80a-46(b)) is amended to read as follows:

"(b)(1) A contract that is made, or whose performance involves, a violation of this title, or of any rule, regulation, or order thereunder, is unenforceable by either party (or by a nonparty to the contract who acquired a right under the contract with knowledge of the facts by reason of which the making or performance violated or would violate any provision of this title or of any rule, regulation, or order thereunder) unless a court finds that under the circumstances enforcement would produce a more equitable result than nonenforcement and would not be inconsistent with the purposes of this title.

"(2) To the extent that a contract described in paragaph (1) has been performed, a court may not deny rescission at the instance of any party unless such court finds that under the circumstances the denial of rescission would produce a more equitable result than its grant and would not be inconsistent with the purposes of this title.

"(3) This subsection shall not apply (A) to the lawful portion of a contract to the extent that it may be severed from the unlawful portion of the contract, or (B) to preclude recovery against any person for unjust enrichment.".

H.R. REP. 96-1341

H.R. REP. 96-1341, H.R. Rep. No. 1341, 96TH Cong., 2ND Sess. 1980, 1980 U.S.C.C.A.N. 4800, 1980 WL 12970 (Leg.Hist.)

P.L. 96-477, SMALL BUSINESS INVESTMENT
INCENTIVE ACT OF 1980
DATES OF CONSIDERATION AND PASSAGE
HOUSE SEPTEMBER 23, OCTOBER 1, 1980
SENATE SEPTEMBER 25, 1980
THE HOUSE BILL WAS PASSED IN LIEU
OF THE SENATE BILL.

* * *

PRIVATE ACTIONS

THE CONGRESS HAS LONG TAKEN THE VIEW THAT PRIVATE RIGHTS OF ACTION FOR VIOLATIONS OF THE FEDERAL SECURITIES

LAWS ARE A NECESSARY ADJUNCT TO THE COMMISSION'S ENFORCEMENT EFFORTS.[4] WITH A RELATIVELY SMALL STAFF CHARGED WITH ADMINISTRATIVE RESPONSIBILITY FOR POLICING POTENTIALLY UNLAWFUL SECURITIES-RELATED ACTIVITIES, THE COMMISSION CANNOT BE EXPECTED TO BRING ACTIONS AGAINST EVEN A LARGE PORTION OF THOSE ENGAGED IN SCHEMES, DEVICES AND ACTIVITIES THAT ARE PROHIBITED BY FEDERAL LAW. THEREFORE, PRIVATE LAWSUITS SERVE AS AN ADDED DETERRENT TO CONDUCT MADE UNLAWFUL BY CONGRESS, WITHOUT THE NECESSITY OF GOVERNMENTAL INVOLVEMENT.

AT THE SAME TIME, AND JUST AS IMPORTANT, SUCH LAWSUITS PERFORM A COMPENSATORY FUNCTION. VIOLATIONS OF THESE INVESTOR PROTECTION LAWS DO NOT SIMPLY COMPROMISE THE INTEGRITY OF THE SECURITIES MARKETPLACE THAT CONGRESS HAS FOUND TO BE SO ESSENTIAL TO PRESERVING INVESTOR CONFIDENCE IN THE CAPITAL RAISING EFFORTS OF AMERICAN ENTERPRISE. FRAUDS, MANIPULATIONS, MISREPRESENTATIONS, SELF-DEALING AND OTHER ILLEGAL ACTIVITY CAUSE REAL AND OFTEN SEVERE FINANCIAL INJURY TO INVESTORS, BOTH INDIVIDUAL AND INSTITUTIONAL. PRIVATE

[4] SEE H.R. REPT. NO. 95-640, 9TH CONG., 1ST SESS. 10 (1977).

LAWSUITS, PERMITTING RECOVERY OF DAMAGES WHEN PROPERLY SHOWN, COMPENSATE THESE VICTIMS FOR THE LOSSES THEY SUFFER.

THE RATIONALE FOR IMPLYING PRIVATE RIGHTS OF ACTION UNDER THE SECURITIES LAWS BEYOND THOSE ACTIONS EXPRESSLY PROVIDED FOR HAD BEEN WELL ARTICULATED BY THE SUPREME COURT WHEN IT OBSERVED THAT IMPLIED PRIVATE RIGHTS OF ACTION ALLOWING SHAREHOLDERS TO SUE TO REMEDY THEIR LOSSES WOULD SIGNIFICANTLY ASSIST THE CONGRESSIONAL GOAL OF PROMOTING FAIR CORPORATE SUFFRAGE.[5] BUT IN RECENT YEARS, THE SUPREME COURT TURNED ITS FOCUS TOWARD A STRICT CONSTRUCTION OF STATUTORY LANGUAGE AND EXPRESSED INTENT.[6]

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[5] J. I. CASE CO. V. BORAK, 377 U.S. 426, AT 433[7] (1964).

[6] TOUCHE ROSS & CO. V. REDINGTON, 442 U.S. 560 (1979); TRANSAMERICA MORTGAGE INVESTORS, INC. V. LEWIS, 444 U.S. 11 (1979). IN TRANSAMERICA, AS IN REDINGTON, THE COURT DID NOT GO BEYOND A CONSIDERATION OF HISTORICAL CONGRESSIONAL INTENT TO A CONSIDERATION OF THE NEED FOR THE PRIVATE REMEDY, OR ITS ROLE IN EFFECTUATING CONGRESS' PURPOSE IN ENACTING THE PROVISION. ALTHOUGH THE COURT AGREED THAT THE STATUTE WAS DESIGNED FOR THE EXPRESS PURPOSE OF PROTECTING ADVISER'S CLIENTS, AND THOSE CLIENTS OFFERED TO SHOW BOTH THAT THE LAW WAS VIOLATED AND THAT THEY SUFFERED MONETARY LOSS AS A RESULT, THE

(Continued on following page)

THE COMMITTEE WISHES TO MAKE PLAIN THAT IT EXPECTS THE COURTS TO IMPLY PRIVATE RIGHTS OF ACTION UNDER THIS LEGISLATION, WHERE THE PLAINTIFF FALLS WITHIN THE CLASS OF PERSONS PROTECTED BY THE STATUTORY PROVISION IN QUESTION. SUCH A RIGHT WOULD BE CONSISTENT WITH AND FURTHER CONGRESS' INTENT IN ENACTING THAT PROVISION, AND WHERE SUCH ACTIONS WOULD NOT IMPROPERLY OCCUPY AN AREA TRADITIONALLY THE CONCERN OF STATE LAW.[8] IN APPROPRIATE INSTANCES, FOR EXAMPLE, BREACHES OF FIDUCIARY DUTY INVOLVING PERSONAL MISCONDUCT SHOULD BE REMEDIED UNDER SECTION 36(A) OF THE INVESTMENT COMPANY ACT. WITH RESPECT TO BUSINESS DEVELOPMENT COMPANIES, THE COMMITTEE CONTEMPLATES SUITS BY SHAREHOLDERS AS WELL AS BY THE COMMISSION, SINCE THESE ARE THE PERSONS THE PROVISION IS DESIGNED TO PROTECT, AND SUCH PRIVATE RIGHTS OF ACTION WILL

COURT WOULD NOT IMPLY A PRIVATE CAUSE OF ACTION FOR DAMAGES ON THEIR BEHALF.

[7] 84 S.CT. 1555, 12 L.ED.2D 423.

[8] THESE ARE ESSENTIALLY THE TESTS ENUNCIATED BY THE COURT IN CORT V. ASH, 422 U.S. 66[10] (1975).

ASSIST IN CARRYING OUT THE REMEDIAL PURPOSES OF SECTION 36.[9]

SECTION-BY-SECTION ANALYSIS

*   *   *

SECTION 104. VALIDITY OF CONTRACTS

SECTION 104 OF THE BILL REPLACES THE PRESENT SECTION 47(B) OF THE ACT IN ITS ENTIRETY. ALTHOUGH PARTIALLY BASED UPON PROPOSED SECTION 1722 OF THE PROPOSED AMERICAN LAW INSTITUTE FEDERAL SECURITIES CODE (AS ADOPTED BY THE ALI ON MAY 19, 1978), THE AMENDED SECTION DIFFERS FROM THAT PROVISION AND FROM THE PRESENT SECTION 47(B) IN SEVERAL RESPECTS.

THE TERMS OF PRESENT SECTION 47(B) DECLARE A CONTRACT VOID, AS REGARDS THE RIGHTS OF THE VIOLATOR OR NONPARTIES TO THE CONTRACT WITH ACTUAL KNOWLEDGE OF ITS ILLEGALITY, IF MADE OR PERFORMED IN VIOLATION OF THE ACT OR A RULE THEREUNDER. NEW SECTION 47(B) STIPULATES THAT A CONTRACT WHOSE TERMS VIOLATE THE ACT

[9] SEE TANNENBAUM V. ZELLER, 552 F.2D 402, 416-17 (2D CIR. 1976), CERT. DENIED, 434 U.S. 934 (1977); MOSES V. BURGIN, 445 F.2D 369, 373 (1ST CIR.), CERT. DENIED, 404 U.S. 994 (1971); H.R. REP NO. 1382, 91ST CONG., 2D SESS. 38 (1970).

IS UNENFORCEABLE BY EITHER PARTY OR BY A NONPARTY TO THE CONTRACT WHO ACQUIRED A RIGHT UNDER THE CONTRACT WITH KNOWLEDGE OF THE FACTS BY REASON OF WHICH THE MAKING OR PERFORMANCE OF IT VIOLATED THE ACT. THE AMENDED SECTION, HOWEVER, SAVES SUCH CONTRACTS IF A COURT FINDS THAT ENFORCEMENT (1) WOULD PRODUCE A MORE EQUITABLE RESULT THAN NONENFORCEMENT AND (2) WOULD NOT BE INCONSISTENT WITH THE PURPOSES OF THE ACT. THE SAME TWO-PART TEST IS APPLIED TO SAVE FROM RESCISSION ANY PORTION OF SUCH A CONTRACT WHICH HAS BEEN PERFORMED. THE AMENDED SECTION, TO A CERTAIN EXTENT, CODIFIES CASE LAW UNDER THE PRESENT SECTION, AND ITS ANALOGS IN OTHER SECURITIES LAWS, BY REQUIRING A COURT TO EXAMINE THE EQUITIES OF THE SITUATION AND THE PURPOSES OF THE ACT IN CONNECTION WITH ITS DECISION. THE AMENDED SUBSECTION DOES NOT APPLY (A) TO ANY LAWFUL PORTION OF A CONTRACT TO THE EXTENT THAT IT MAY BE SEVERED FROM AN UNLAWFUL PORTION OF [SIC] (B) TO PRECLUDE RECOVERY AGAINST ANY PERSON FOR UNJUST ENRICHMENT. THESE LATTER PROVISIONS ENUNCIATE EQUITABLE PRINCIPLES UPON WHICH INTERPRETATION AND

UTILIZATION OF THE PRESENT SECTION HAVE BEEN BASED.

*   *   *

PUBLIC LAW 91-547 – DEC. 14, 1970

AN ACT

To amend the Investment Company Act of 1940 and the Investment Advisers Act of 1940 to define the equitable standards governing relationships between investment companies and their investment advisers and principal underwriters and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may, be cited as the "Investment Company Amendments Act of 1970".

* * *

"BREACH OF FIDUCIARY DUTY

"SEC. 36. (a) The Commission is authorized to bring an action in the proper district court of the United States, or in the United States court of any territory or other place subject to the jurisdiction of the United States, alleging that a person serving or acting in one or more of the following capacities has engaged within five years of the commencement of the action or is about to engage in any act or practice constituting a breach of fiduciary duty involving personal misconduct in respect of any registered investment company for which such person so serves or acts –

"(1) as officer, director, member of any advisory board, investment, adviser, or depositor; or

"(2) as principal underwriter, if such registered company is an open-end company, unit investment trust, or face-amount certificate company.

If such allegations are established, the court may enjoin such persons from acting in any or all such capacities either permanently or temporarily and award such injunctive or other relief against such person as may be reasonable and appropriate in the circumstances, having due regard to the protection of investors and to the effectuation of the policies declared in section (b) of this title.

"(b) 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. With respect to any such action the following provisions shall apply:

"(1) It shall not be necessary to allege or prove that any defendant engaged in personal misconduct, and the plaintiff shall have the burden of proving a breach of fiduciary duty.

"(2) In any such action approval by the board of directors of such investment company of such compensation or payments, or of contracts or other arrangements providing for such compensation or payments, and ratification or approval of such compensation or payments, or of contracts or other arrangements providing for such compensation or payments, by the shareholders of such investment company, shall be given such consideration by the court as is deemed appropriate under all the circumstances.

"(3) No such action shall be brought or maintained against any person other than the recipient of such compensation or payments, and no damages or other relief shall be granted against any person other than the recipient of such compensation or payments. No award of damages shall be recoverable for any period prior to one year before the action was instituted. Any award of damages against such recipient shall be limited to the actual damages resulting from the breach of fiduciary duty and shall in no event exceed the amount of compensation or payments received from such investment company, or the security holders thereof, by such recipient.

"(4) This subsection shall not apply to compensation or payments made in connection with transactions subject to section 17 of this title, or rules, regulations, or orders thereunder, or to sales loans for the acquisition of any security issued by a registered investment company.

"(5) Any action pursuant to this subsection may be brought only in an appropriate district court of the United States.

"(6) No finding by a court with respect to a breach of fiduciary duty under this subsection shall be made a basis (A) for a finding of a violation of this title for the purposes of sections 9 and 49 of this title, section 15 of the Securities Exchange Act of 1934, or section 203 of title II of this Act, or (B) for an injunction to prohibit any person from serving in any of the capacities enumerated in subsection (a) of this section."

* * *

[SEAL]

U.S. Securities and
Exchange Commission

Legal Brief:
Sidney Olmsted and Johanna Olmsted v.
Pruco Life Insurance Company of New Jersey
and Prudential Insurance Company of America

No. 00-9511

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

SIDNEY OLMSTED and JOHANNA OLMSTED,

Plaintiffs-Appellants,

v.

PRUCO LIFE INSURANCE COMPANY
OF NEW JERSEY and THE PRUDENTIAL
INSURANCE COMPANY OF AMERICA,

Defendants-Appellees,

On Appeal from the United States District Court
for the Southern District of New York

BRIEF OF THE SECURITIES AND EXCHANGE
COMMISSION, AMICUS CURIAE, SUBMITTED
AT THE COURT'S REQUEST

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Restatement of Contracts (Second) No. 00-9511

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

SIDNEY OLMSTED and JOHANNA OLMSTED,
Plaintiffs-Appellants,

v.

PRUCO LIFE INSURANCE COMPANY
OF NEW JERSEY and THE PRUDENTIAL
INSURANCE COMPANY OF AMERICA,
Defendants-Appellees.

On Appeal from the United States District Court
for the Southern District of New York

BRIEF OF THE SECURITIES AND
EXCHANGE COMMISSION, AMICUS CURIAE,
SUBMITTED AT THE COURT'S REQUEST

ARGUMENT

The Securities and Exchange Commission submits this brief in response to the Court's request that it address the issue "whether Sections 26 and 27 of the Investment Company Act (ICA) provide private rights of action."

The Court and the parties have focused on implied rights to damages under Sections 26 and 27 themselves. We believe, however, that the most appropriate private remedy for a violation of the requirement that aggregate fees and charges for variable insurance contracts be reasonable is the express remedy set forth in Section 47(b) of the ICA, which permits rescission of the portion of the contract that establishes an unreasonable price, together with restitution of the excess amounts paid. 15 U.S.C. 80a-46. Section 47(b) permits rescission of any contract that is made or whose performance involves a violation of any section of the Act as well as restitution of the consideration paid for such a contract, subject to the court's equitable authority. In our view, this express remedy would provide complete relief for the violations alleged in this case. In addition, express private remedies under Sections 11 and 12(a)(2) of the Securities Act of 1933, 15 U.S.C. 77k and 77l(a)(2), and the established private remedy under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5, would be available, if the elements of those causes of action are met, though recovery under each of these provisions could involve difficulties that would make the remedy ineffective in this type of case.

Because of the availability and adequacy of the express Section 47(b) remedy, it is not necessary for the court to decide whether there also are duplicative implied damage remedies under Sections 26 and 27, and we take no position on that question. In this connection, we do note that the Supreme Court has expressed reluctance to recognize implied rights of action under statutes that contain express remedies. See Virginia Bankshares v. Sandberg, 501 U.S. 1083, 1104 (1991); Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 19-20 (1979). That reluctance could be particularly pronounced where, as here, there is a rescissionary remedy on the face of the statute that provides adequate express relief for the alleged harm.

We begin with a review of the history of Sections 26(f) and 27(i). We then turn to remedies under Section 47(b) and the other provisions cited above.

I. The reasonable fee requirement in Sections 26(f) and 27(i)

A variable annuity is a contract under which an insurer, in return for a lump sum payment or a series of payments during the "accumulation" period, agrees to make a series of payments to the contract owner for life or for a specified period.[1] Premium payments for variable annuities are allocated to investment portfolios maintained by an insurance company in a "separate account." The value of what the contract owner may ultimately receive depends upon the performance of the separate account into which his or her payments

[1] This description of the product and fees is taken from SEC Division of Investment Management, Protecting Investors: A Half Century of Investment Company Regulation 373-74, 384-86 (May 1992) ("Protecting Investors").

have been invested. Because contract owners assume certain investment risks under the contracts, the contracts are securities under the securities laws and the separate accounts funding the contracts are investment companies under the ICA.

The insurance company charges various types of fees under the contract. This case alleges that the mortality and expenses risk charges under the contracts are unreasonable and that they therefore violate Sections 26(f) and 27(i) of the ICA.[2]

Before they were amended by the National Securities Market Improvement Act of 1996 ("NSMIA"), Sections 26 and 27 and the rules thereunder restricted variable annuities in ways that created a number of business and regulatory problems because the annuities differed in key respects from the typical investment products covered by these provisions. For example,

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[2] Protecting Investors at 385-86 explained:

> The insurer assumes a mortality risk when it guarantees annuity rates to contract owners. These annuity rates are based on mortality projections for future annuitants. In the event that the actual mortality rates differ from projections * * * , the insurer remains obligated to pay annuity benefits as guaranteed in the contract. Some insurers also assume a mortality risk by agreeing to pay a death benefit if the annuitant dies before a specified time. The insurer assumes an expense risk when an annuity contract guarantees that administrative charges under the contract will not increase even if actual administrative costs increase during the life of the contract.

these sections prohibited mortality and expenses risk charges entirely, absent an exemptive order from the Commission.[3] The Commission had attempted to address these problems by adopting exemptive rules and by granting exemptive orders on a case-by-case basis, but these efforts did not entirely eliminate the difficulties.

In 1990, the Commission issued a broad request for comments on reform of the regulation of investment companies. IC Rel. No. 17534 (June 15, 1990). One of the areas as to which comments were sought was whether Sections 26 and 27 should be amended as they applied to variable insurance products. See Section H.1 ("Insurance Products Under the Federal Securities Laws – Variable Insurance Contracts.")

The American Council of Life Insurance (ACLI) submitted an extensive comment letter (relevant sections of the letter are attached hereto at Tab A). The ACLI's principal recommendation was that Sections 26 and 27 be amended to create an exemption from the fee restrictions imposed under those provisions for variable contracts that met certain specified requirements. Specifically, the ACLI proposed adoption of Section 26(e), which would exempt insurance company separate accounts from Section 26(a) if, among other

[3] For a summary of the pre-1996 situation, the problems arising therefrom, and a set of recommendations for addressing those problems, see Protecting Investors at 373-78. For a more detailed description, see id. at 378-402.

conditions, the insurance company represented in the registration statement for each contract that the charges and fees deducted from the assets in the account "in the aggregate" were either (a) "within the range of industry practice for comparable contracts," or (b) "reasonable in relation to the services rendered, the expenses expected to be incurred and the risks assumed by the insurer." ACLI Letter at 10-11.[4] The ACLI also proposed to add Section 27(i), which would exempt from Section 27 any separate account funding variable annuity contracts provided that the insurance company "satisfies the conditions in Section 26(e)," including the representation concerning aggregate fees and charges. Id. at 12-13.

The ACLI Letter discussed the private remedies that would be available under its proposal. It observed that under the existing statute, variable contract issuers obtained relief for pricing and distribution issues through individual exemptive orders, and that "contravention of an exemptive order may establish liability for rescission of contracts by virtue of Section

[4] The requirement that the insurance company make these representations in the registration statement as a condition of being exempted from Section 26(a) was taken from proposed Commission Rule 26a-3. See Rel. No. IC-14190 (Oct. 11, 1984); ACLI Letter at 11 n.7. The proposed rule, in turn, was a codification of standards the Commission had developed with respect to applications seeking exemptions for variable contracts. This version of the proposed rule was withdrawn and a different version proposed, but that version was not adopted.

47(b)" of the ICA. ACLI Letter at 50. Under its proposal, it explained,

> the inclusion of the representations in the registration statement provides individuals with a potential private right of action pursuant to Rule 10b-5 under the [Securities Exchange Act] for misstatements if actual charge levels deviate from representations. Additional statutory liabilities may exists [sic] pursuant to Sections 11 and 12[a](2) of the [Securities Act] and Section 18(a) of the [Securities Exchange] Act. In addition, contract owners would continue to enjoy the remedies under the current exemptive order mechanism noted above.

ACLI Letter at 51.

Protecting Investors was the report of the Commission's Division of Investment Management that grew out of the request for comments. It recommended amendments to Sections 26 and 27 similar to the ACLI proposal.[5] The Division recommended that the insurance company be required to represent that the fees were "reasonable." Also, where the ACLI proposal would have required only that issuers represent that the fees and charges were reasonable, the Division's recommendation added the substantive requirement

[5] See Protecting Investors at 404 n.122 (discussing some of the differences between the Division's proposal and the ACLI's proposal). For a general discussion of the Division's proposal, see id. at 402-17.

that those fees and charges actually be reasonable. The Division did not expressly discuss the availability of private remedies, but it did note that under its recommendation, "[i]ssuers would remain subject to the Securities Act and all other provisions of the Investment Company Act." Protecting Investors at 411.

NSMIA substantially adopted the amendments recommended by the Division, adding Section 26(f) (then numbered Section 26(e)), and Section 27(i) to the Act.[6] Section 26(f)(1) states that Section 26(a), with its restrictions on charges, does not apply to any registered separate account funding variable insurance products, or to the sponsoring insurance company and principal underwriter of such account. Section 26(f)(2)(A) provides, in relevant part, that it shall be unlawful for any registered separate account funding variable insurance contracts, or for the sponsoring insurance company of such account, to sell any such contract "unless the fees and charges deducted under the contract, in the aggregate, are reasonable in relation to the services rendered, the expenses expected to be incurred, and the risks assumed by the insurance company and * * * the insurance company so represents in the registration statement for the contract."

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[6] The renumbering of Section 26(e) has caused a certain amount of confusion. Plaintiffs and the district court referred to the provision as Section 26(e), as does Section 27(i), which incorporates the requirements of Section 26(f) by reference. We will refer to the section as 26(f).

Section 27(i), similarly to Section 26(f)(1), excepts variable insurance products from the provisions of Section 27, except as provided in Section 27(i)(2). Section 27(i)(2)(B) provides, in relevant part, that it shall be unlawful for any registered separate account funding variable insurance contracts, or for the sponsoring insurance company of such account, to sell any such contract unless "the insurance company complies with section 26[(f)]."

The effect of these amendments was to replace the prior limitations on mortality and expenses risk charges and other fees with a requirement that the contract not be sold unless the fees and charges under it are reasonable in the aggregate.

II. <u>Rescission of unreasonable fees under Section 47(b) of the ICA</u>

Section 47(b), which was adopted in its current form in 1980, enacts a version of the common law doctrine of "void for illegality." Section 47(b)(1) provides that a "contract that is made, or whose performance involves, a violation of" the Act "is unenforceable by either party * * * unless a court finds that under the circumstances enforcement would produce a more equitable result than non-enforcement and would not be inconsistent with the purposes of [the Act]." Section 47(b)(2) states that to the extent that such a contract has been performed, "a court may not deny rescission at the instance of any party unless such court finds that under the circumstances the denial of rescission would produce a more equitable result than its grant and would not be inconsistent with the purposes of [the Act]." Finally, Section 47(b)(3) provides that the subsection shall not apply "to the lawful portion of a contract to the extent that it may be severed from the unlawful portion of the contract" or "to preclude recovery against any person for unjust enrichment."[7]

The Supreme Court precedent makes clear beyond reasonable dispute that private plaintiffs may seek rescission of a contract provision charging excessive fees. The principal case is Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11 (1979), where the Supreme Court construed Section 215, 15 U.S.C. 80b-15, of the Investment Advisers Act, a provision similar to Section 47(b), to permit rescission and restitution where a contract is contrary to the statute, while at the same time finding no implied right of action for damages under the antifraud provision of that Act.[8] The Court explained that the language of

[7] Section 47(b) is thus consistent with the well-recognized doctrine that "[w]hen a legislative prohibition of certain acts is for the benefit of a small or large class (perhaps the public at large), the illegality will not prevent restitution in favor of a person in the protected class." G. Palmer, Law of Restitution, vol.II (1978), section 8.6, p. 206 (1978); Restatement of Contracts (Second), Section 198(b), Comment b and illustration 2 (1981).

[8] Both Section 215 of the Advisers Act and the pre-1980 version of Section 47(b), declared a contract that violated the statute to be "void." See 444 U.S. at 16-17 (quoting Section 215); H.R. Rep. 96-1341, 37 (Sept. 17, 1980), reprinted 1980 U.S.C.C.A.N. 4800, 4891 (describing pre-1980 Section 47(b)).

the statute "fairly implies a right to specific and limited relief":

> By declaring certain contracts void, Section 215 by its terms necessarily contemplates that the issue of voidness under its criteria may be litigated somewhere. At the very least Congress must have assumed that Section 215 could be raised defensively in private litigation to preclude the enforcement of an investment advisers contract. But the legal consequences of voidness are typically not so limited. A person with the power to avoid a contract ordinarily may resort to a court to have the contract rescinded and to obtain restitution of consideration paid.

444 U.S. at 18. Therefore, the statute created the right to sue for "rescission or for an injunction against continued operation of the contract, and for restitution." 444 U.S. at 19. See also Mathers Fund Inc. v. Colwell Co., 564 F.2d 780, 783 (7th Cir. 1977) (pre-Transamerica decision holding that Section 47(b) "contemplates civil suits for relief by way of rescission and for damages").[9]

This reasoning applies equally to Section 47(b), as the ACLI Letter recognized. Moreover, Congress was aware of Transamerica at the time it amended the section in 1980 -- the legislative history of the bill

[9] After Transamerica, the financial relief available under Section 47(b) is more accurately described as restitution, rather than damages.

containing the amendment expressly cites the case in discussing private rights of action. See H.R. 96-1341 at 28 n.6. Indeed, given the explicit language in Section 47(b)(2) that creates a presumption in favor of rescission, the remedy under the current version of Section 47(b) should be viewed as an express rather than an implied one.

A violation of Section 26(f) or 27(i) would clearly give rise to a cause of action under Section 47(b). As noted, those sections make it unlawful for a registered separate account funding variable insurance contracts or a sponsoring insurance company for such account to sell any contract that charges unreasonable fees. Thus, in the language of Section 47(b)(1), a contract containing a provision charging excessive fees would be "made" in violation of the Act, and the "performance" of the contract would "involve[ ]" a violation.

Section 47(b) gives the district courts broad equitable discretion to order the appropriate remedy for violations. See H.R. Rep. 96-1341, 37 ("The amended section * * * requir[es] a court to examine the equities of the situation and the purposes of the Act in connection with its decision."); see Mathers Fund Inc., 564 F.2d at 783 (relief under Section 47(b) "must * * * be fashioned to comport with, and further the policies of, the overall legislative scheme of which" the provision is a part). In particular, as noted above, Section 47(b)(3)(A) provides that the court should not rescind "the lawful portion of a contract to the extent that it may be severed from the unlawful portion of the contract." Therefore, the proper remedy in the usual case would be to sever and rescind the "unlawful portion" of the contract -- the portion that creates the unreasonable fees -- but to enforce the portion that is reasonable. Restitution of the overcharges could be ordered pursuant to Section 47(b)(3)(B), which expressly permits recovery for unjust enrichment. See H.R. Rep. 96-1341, 37 (subsections (3)(A) and (B) "enunciate equitable principles upon which interpretation and utilization of the present section have been based").

There is little decisional law on rescission under Section 47(b) or the similar provisions in the other securities laws. The approach taken under that section, however, in which the unlawful portion of a contract term may be severed from the lawful part and the lawful part enforced, is consistent with modern contract law as represented by the Restatement (Second) of Contracts (1981). See generally Restatement Ch. 8. We note that the Restatement was adopted shortly after the 1980 amendment to Section 47(b), and that it had been circulating for a number of years prior to that in a draft form that had been treated as authoritative by the courts.[10]

Eschewing the more mechanical approach prevailing in earlier contract law, the Restatement permits courts to exercise their equitable discretion to rescind

[10] See, e.g., Albert Elia Bldg. Co. v. American Sterilizer Co., 622 F.2d 655, 656 (2d Cir. 1980) (citing Restatement Tentative Draft No. 10, 1975).

unlawful parts of a contract in such a way as to effectuate a just result. See Restatement Sections 178 (when a term is unenforceable on grounds of public policy); 183 (when agreement is enforceable as to agreed equivalents); and 184 (when rest of agreement is enforceable).

Of particular relevance here is Section 184, which provides that under some circumstances, a court may treat "part of a term" as unenforceable:

> (1) If less than all of an agreement is enforceable under the rule stated in Section 178 [the section that states when a term of a contract is unenforceable on grounds of public policy], a court may nevertheless enforce the rest of the agreement in favor of a party who did not engage in serious misconduct if the performance as to which the agreement is unenforceable is not an essential part of the agreed exchange.
>
> (2) A court may treat only part of a term as unenforceable under the rule stated in Subsection (1) if the party who seeks to enforce the term obtained it in good faith and in accordance with reasonable standards of fair dealing.

Comment b to Section 184 explains that:

> Sometimes a term is unenforceable on grounds of public policy because it is too broad, even though a narrower term would be enforceable. In such situation, under Subsection (2), the court may refuse to enforce

> only part of the term, while enforcing the other part of the term as well as the rest of the agreement. The court's power in such a case is not a power of reformation, however, and it will not, in the course of determining what part of the term to enforce, add to the scope of the term in any way.

The illustrations to Comment b flesh out this guidance. Covenants in restraint of trade that prohibit too many activities (illustration 2) or cover too large a geographic area (illustration 3) are enforceable with respect to activities that could reasonably be prohibited and within a reasonable geographic area. A waiver of liability for "willful or negligent" breach of duty (illustration 4) is enforceable with respect to negligence. And, most pertinently to the issues in this case, a promise to pay an interest rate in excess of the highest permissible legal rate (illustration 5) is "enforceable up to the highest permissible rate" even though "part of the promise" is unenforceable.[11]

While Section 47(b) and Section 184 use different terminology, the provisions adopt substantially similar

[11] This illustration states that if the lender knew of the violation, the borrower's agreement to repay would be unenforceable in its entirety. We cite the illustration, however, not to urge that every detail of the Restatement's view of usury law should be applied to Section 47(b), but only to demonstrate that a court faced with a contract provision imposing an unreasonable charge (interest in the Restatement illustration and fees under Sections 26(f) and 27(i)) has the power to rescind the excessive amount and enforce the remainder.

rules. Thus, in relevant part, Section 47(b) states that rescission should be allowed unless the court "finds that under the circumstances the denial of rescission would produce a more equitable result than its grant and would not be inconsistent with the purposes of" the ICA, that the "lawful portion of a contract" may be "severed from the unlawful portion," and only the unlawful portion rescinded, while Section 184(2) provides that a court may "treat only part of a term as unenforceable" if the party seeking enforcement obtained its rights under the contract "in good faith and in accordance with reasonable standards of fair dealing," and if "the performance as to which the agreement is unenforceable is not an essential part of the agreed exchange."

We particularly note that Section 184(2)'s focus on "part of a term" is similar to Section 47(b)'s use of the term "portion of a contract," in that both suggest that the rescission does not have to apply only to an entire "term" or "provision." Decisions under Section 184(2), therefore, appropriately provide additional guidance about the nature of the remedy created by Section 47(b).

In a case decided under state law, this Court endorsed Section 184(2)'s approach to rescission of a "part of a term." Like the first two illustrations cited above, the issue in Deringer v. Strough, 103 F.3d 243 (2d Cir. 1996), was whether a non-compete agreement that could not be enforced as written because it was unreasonable could nonetheless be enforced to the extent that the restrictions imposed were reasonable.[12] Technically, the case was governed by Vermont law, but there were no Vermont decisions on point. 103 F.3d at 247. This Court therefore considered Section 184(2), as well as its own decisions and decisions of other courts, before concluding that Vermont would "permit enforcement of a defective restrictive covenant to the limit of its validity." 103 F.3d at 247-48 (emphasis added).[13] The same principle should be applied to actions under Section 47(b), allowing a court to "permit enforcement" of a fee provision to the "limit of its validity," i.e., to the maximum reasonable amount.

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[12] The section of the first Restatement of Contracts from which Section 184 is derived was limited to promises in restraint of trade, such as non-compete agreements, while Section 184 is stated so as to apply to contract terms generally. See Section 184, Reporter's Note. Thus, as suggested by the illustrations, which involve promises in restraint of trade, waivers of tort liability, and violation of usury laws, the same principles apply whatever the nature of the violation of public policy that renders a term partially unenforceable.

[13] Other decisions applying Section 184(2) to non-compete agreements, ruling that where such agreements are unreasonable because overbroad, the unreasonable portion of the agreement would be severed and declared void, but that the remaining portion of the agreement would still be enforced, include BDO Seidman v. Hirschberg, 712 N.E. 2d 1220 (N.Y. 1999); Simpson v. C & R Supply, Inc., 598 N.W. 2d 914, 919-20 (S.D. 1999); Hopper v. All Pet Animal Clinic, Inc., 861 P.2d 531, 545-47 (Wyo. 1993); Central Adjustment Bureau, Inc. v. Ingram, 678 S.W.2d 28, 35-37 (Tenn. 1984).

Other courts have also looked to Section 184(2) in deciding to enforce only the portion of a contract term that does not violate public policy. Particularly instructive are a line of cases involving exclusions in insurance policies that were void because they violated state laws requiring insurance up to a specified amount. In each case, the court voided the exclusion as contrary to public policy, but only up to the statutory amount, not to the entire policy amount. Thus, in Nichols v. Anderson, 837 F.2d 1372, 1374-76 (5th Cir. 1988), the court ruled that a clause in an insurance policy limiting coverage to accidents within 150 miles of a certain town was void because it was contrary to a state law requiring common carriers to have $25,000 of insurance coverage. The court applied Section 184(2), which it explained "would adjust the contract as little as possible to enable the parties to have a contract as close to what they originally intended as possible." 837 F.2d at 1376. Therefore, the court voided the geographic restriction "only to the extent required to meet the public policy," which meant up to $25,000, not the full $100,000 provided on the face of the policy.[14]

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[14] Nichols was followed in Canal Insurance Co. v. Ashmore, 126 F.3d 1083, 1085, 1087-88 (8th Cir. 1997), where the court found that an exclusion for bodily injuries to occupants of the insured vehicle violated the same requirement that common carriers have $25,000 in insurance that was at issue in Nichols. Relying on that case, the court voided the exclusion, but again only up to $25,000 rather than the $750,000 face amount of the policy. In Canal Insurance Co. v. Benner, 980 F.2d 23, 25-27 (1st

(Continued on following page)

Courts have also recognized that the power to rescind contracts should be applied so as to do equity on the facts of the case. In Mills v. Electric Auto-Lite Co., 396 U.S. 375, 386-88 (1970), the Supreme Court explained that in selecting the remedy for violation of the Securities Exchange Act's proxy disclosure requirements, courts should exercise the sound discretion which guides the determination of courts of equity, keeping in mind the role of equity as the instrument for nice adjustment and reconciliation between the public interest and private needs as well as between competing private claims. It also noted that the same principles apply in a rescission action under the Securities Exchange Act version of Section 47(b), Section 29(b), 15 U.S.C. 78cc(b).

In other cases, courts have ameliorated the effects of rescission by reducing the amount of restitution ordered for illegal charges by the amounts the defendants could legally have charged.[15] For instance, in Aydt v. De Anza Santz [sic] Cruz Mobile Estates, 763 F. Supp. 970, 975 (N.D. Ill. 1991), the court ruled that the defendant, a landlord, had to return the portion of

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Cir. 1992), the First Circuit similarly relied on Nichols and Section 184(2) in ruling that, where an insurance policy contained an exclusion for bodily injury that was void because it was contrary to public policy, the insurer was obligated to pay only the minimum amount required by the relevant state financial responsibility statute rather than the full amount of liability coverage provided by the policy.

[15] In these cases, the defendant had already provided a service, so a return to the status quo ante was not possible.

the rent he had no right to charge but could retain the amount he legally could have charged under the rent-control law. Similarly, in C.J. Roten v. Tesdell & Mackaman, 192 N.W. 442 (Iowa 1923), the court ruled that where a contract between a law firm and a client was void because it provided for an illegal contingency fee, the law firm could retain the reasonable value of its services.[16]

Alternative remedies that could be imagined here, such as voiding the entire contract, voiding only the investor's obligation to pay while requiring the insurer to continue to provide the insurance benefit, or voiding both the obligation to pay and the insurance term, would create precisely the sort of drastic upsetting of the parties' reasonable expectations that led courts and commentators to endorse the more flexible modern approach. Common sense and the statutory language both counsel that only the excessive amount of the fees should be rescinded.

III. Remedies under other provisions of the federal securities laws.

Section 26(f)(2)(A) requires an issuer of a variable annuity contract to represent in the registration

[16] See also Williams J. Davis, Inc. v. Slade, 271 A.2d 412 (D.C. Ct. App. 1970) (even though a lease was illegal, and the tenant could recover rent paid under the lease, the landlord could retain the reasonable value of the rental); G. Palmer, Law of Restitution, vol. II, Section 8.8, pp. 227-28 (1978); Corbin, Corbin on Contracts, vol. 6A, Section 1540, pp. 836-37 (1962).

statement for the contract that the fees and charges under the contract are reasonable. As noted in the ACLI Letter, if this representation is false, it could give rise to claims under Section 11 and 12(a)(2) of the Securities Act and Section 10(b) and Rule 10b-5 under the Securities Exchange Act.

Section 11(a) of the Securities Act, 15 U.S.C. 77k(a), provides an express damages action against the issuer and various others involved in the offering for material misrepresentations in a registration statement, and there would seem to be no question that, if a person purchases a variable annuity, and the registration statement for that annuity contains the false representation that the fees and charges are reasonable, that person may sue. However, Section 11 contains a restriction on the available damages that could limit the remedy severely. Section 11(e) provides, in relevant part, that a suit under Section 11(a) "may be to recover such damages as shall represent the difference between the amount paid for the security * * * and the value thereof as of the time such suit was brought." Thus, unless the value of the annuity at the time of suit is less than the purchase price, no damages may be recovered. Moreover, Section 11(e) also provides that if the defendant proves that "any portion or all of such damages represents other than the depreciation in value of such security resulting from" the misrepresentation "with respect to which his liability is asserted," then "such portion of or all such damages shall not be recoverable."

Section 12(a)(2) of the Securities Act creates an express remedy for material misrepresentations in a prospectus. The Commission's staff, however, has not interpreted Section 26(f)(2)(A) as requiring that the representation of reasonableness be made in the prospectus portion of the registration statement, and it is our understanding that the representation is typically not contained in that portion. Furthermore, Section 12(a)(2) also contains a restriction on the available damages that could make the remedy ineffective in most cases.

Section 10(b) and Rule 10b-5 provide an already well-established implied cause of action for material misrepresentations made with scienter. Assuming that scienter could be established, an additional difficulty arises from the fact that, as a general matter, proof of reliance is an element of the claim. See, e.g., Basic v. Levinson, 485 U.S. 224, 243 (1988); Simon DeBartolo Group, L.P. v. The Richard E. Jacobs Groups, Inc., 186 F. 3d 157, 173 (2d Cir. 1999). Perhaps a plaintiff who has not seen the registration statement would not be able to claim that he had relied on a false representation in it. On the other hand, it could be argued that investors are reasonably relying on the fact that the law requires the representation to be made in the registration statement as a condition of the legal sale of the security, even though the investor does not actually see the document prior to purchase. Cf. Basic v. Levinson, 485 U.S. at 243-44 ("causal connection" between misrepresentation and injury can be proved in other ways than by showing reliance).

Thus, while a misrepresentation as to the reasonableness of the fees could theoretically give rise to claims under these three provisions, there are substantial practical problems with relying on them to remedy any violations of Sections 26(f) and 27(i).

CONCLUSION

Accordingly, we believe that an action to rescind the illegal portion of the contract under Section 47(b) is the most appropriate remedy under the circumstances. That remedy is express, affords full relief and avoids the legal issues that would be involved in the assertion of an implied right of action for damages under Sections 26 and 27.

Respectfully submitted,

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December 5, 2001

[SEAL]

U.S. Securities and
Exchange Commission

Variable Annuities:
What You Should Know

Variable annuities have become a part of the retirement and investment plans of many Americans. Before you buy a variable annuity, you should know some of the basics – and be prepared to ask your insurance agent, broker, financial planner, or other financial professional lots of questions about whether a variable annuity is right for you.

This is a general description of variable annuities – what they are, how they work, and the charges you will pay. Before buying any variable annuity, however, you should find out about the particular annuity you are considering. Request a prospectus from the insurance company or from your financial professional, and read it carefully. The prospectus contains important information about the annuity contract, including fees and charges, investment options, death benefits, and annuity payout options. You should compare the benefits and costs of the annuity to other variable annuities and to other types of investments, such as mutual funds.

* * *

What Is a Variable Annuity?

A variable annuity is a contract between you and an insurance company, under which the insurer agrees to make periodic payments to you, beginning either immediately or at some future date. You purchase a variable annuity contract by making either a single purchase payment or a series of purchase payments.

A variable annuity offers a range of investment options. The value of your investment as a variable annuity owner will vary depending on the performance of the investment options you choose. The investment options for a variable annuity are typically mutual funds that invest in stocks, bonds, money market instruments, or some combination of the three.

Although variable annuities are typically invested in mutual funds, variable annuities differ from mutual funds in several important ways:

* * *

Variable Annuity Charges

You will pay several charges when you invest in a variable annuity. Be sure you understand all the charges before you invest. **These charges will reduce the value of your account and the return on your investment.** Often, they will include the following:

- **Surrender charges** – If you withdraw money from a variable annuity within a certain period after a purchase payment (typically within six to eight years, but sometimes as long as ten years), the insurance company usually will assess a "surrender" charge, which is a type of sales charge.

*   *   *

- **Mortality and expense risk charge** – This charge is equal to a certain percentage of your account value, typically in the range of 1.25% per year.

*   *   *

- **Administrative fees** – The insurer may deduct charges to cover record-keeping and other administrative expenses. This may be charged as a flat account maintenance fee (perhaps $25 or $30 per year) or as a percentage of your account value (typically in the range of 0.15% per year).

*   *   *

- **Underlying Fund Expenses** – You will also indirectly pay the fees and expenses imposed by the mutual funds that are the underlying investment options for your variable annuity.

- **Fees and Charges for Other Features** – Special features offered by some variable annuities, such as a <u>stepped-up death benefit</u>, a <u>guaranteed minimum income benefit</u>, or <u>long-term care insurance</u>, often carry additional fees and charges.

Other charges, such as initial sales loads, or fees for transferring part of your account from one investment option to another, may also apply.

*   *   *

John Hancock
RETIREMENT PLAN SERVICES

Your investment options

[Image Omitted In Printing]

The choice is yours

*　　*　　*

Expense Ratio (ER), also known as the Annual Investment Charge (AIC)

This material shows expenses for a specific unit class for investment options available under a John Hancock USA group annuity contract. The Expense Ratio (ER) includes John Hancock USA's administrative maintenance charge (AMC), sales and service fee, if applicable to that unit class, and the expenses of any underlying mutual fund (based on expense ratios reported in the most recent prospectuses available as of the date of printing) and is subject to change. John Hancock, USA's AMC will be reduced if John Hancock USA or an affiliate receives asset based distribution charges ("12b-1 fees"), sub-transfer agency fees, or other fees from an unaffiliated underlying mutual fund or its agent(s). These fees, collectively, range from 0% to 0.50%. The amount of the AMC charged under each sub-account has been determined net of such fees. The underlying fund expense is determined by the underlying mutual fund company and may be increased or decreased at any time to reflect changes in the expenses of the underlying mutual fund or other factors. In addition, some fund companies charge exchange or redemption fees for mutual fund shares held for less than a certain period of time. Any such charges would be deducted from the value of a participant's account. The ER applies daily at a rate equivalent to the annual rate shown, and may vary to reflect changes in the expenses of an underlying mutual fund and other factors. The ER does not include any contract-level or participant recordkeeping charges. Such charges, if applicable, will reduce the value of a participant's account. The revenue John Hancock USA receives from any of its internally-managed Funds and certain asset allocation portfolios (i.e., the Lifecycle Funds, Lifestyle Funds and the American Funds asset allocation portfolios) may be higher than those advised or sub-advised exclusively by unaffiliated mutual fund companies. John Hancock USA's affiliates provide advisory and sub-advisory services to these internally-managed funds.

*　　*　　*

g Ticker symbol

When contributions are allocated to Funds under your employer's group annuity contract with John Hancock, they will be held in a sub-account (also referred to as "Fund"), which invests solely in shares of the specified underlying mutual fund. The ticker symbols shown are for the underlying mutual funds in which sub-accounts are invested. The ticker symbols do not directly apply to the John Hancock sub-account and therefore any public information accessed using these symbols will not reflect the unit value of the subaccount, nor will such information reflect sub-account or contract-level charges under your plan's group annuity contract.

* * *

File No. 812-13341

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FIRST AMENDED AND RESTATED APPLICATION FOR AN ORDER UNDER SECTION 12(d)(1)(J) OF THE INVESTMENT COMPANY ACT OF 1940 FOR EXEMPTIONS FROM SECTION 12(d)(1)(A) AND 12(d)(1)(B) OF THE ACT AND SECTIONS 6(c) AND 17(b) OF THE ACT EXEMPTING CERTAIN TRANSACTIONS FROM SECTION 17(a) OF THE ACT

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[1] – JOHN HANCOCK TRUST[*]

*   *   *

Please send all communications, notices and orders to:

*   *   *

John J. Danello, Esq.
601 Congress Street
Boston, Massachusetts 02210-2805

As filed with the Securities and Exchange Commission

On May 23, 2007

*   *   *

[4] The Trusts are the only registered investment companies that currently intend to rely on the requested order. Any other entity that relies on the order in the future will comply with the terms and conditions set forth herein.

II. APPLICANTS

A. JHT

JHT (formerly, Manufacturers Investment Trust) is a Massachusetts business trust registered as an open-end management investment company under the Act. Under Massachusetts law and JHT's Agreement and Declaration of Trust dated September 29, 1988, as amended, JHT is managed under the direction of its Board of Trustees. JHT is a series trust which currently offers 110 Portfolios, each of which has its own investment objectives and policies.

* * *

Shares of JHT are registered under the Securities Act of 1933, as amended (the "**1933 Act**").

Shares of JHT are not offered directly to the public. They are offered only to separate accounts ("**Registered Separate Accounts**") of the John Hancock Life Insurance Company (U.S.A.) . . . [5] as the underlying investment vehicles for the . . . variable annuity contracts ("**Variable Contracts**") issued by the Insurance Companies.

* * *

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Attorneys For Plaintiffs

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

DANIELLE SANTOMENNO, for the use and benefit of the John Hancock Trust and the John Hancock Funds II; KAREN POLEY and BARBARA POLEY, for the use and benefit of the John Hancock Funds II; DANIELLE SANTOMENNO, KAREN POLEY and BARBARA POLEY individually and on behalf of Employee Retirement Income Security Act of 1974, as amended ("ERISA"), employee benefit plans that held, or continue to hold, group variable annuity contracts issued/sold by	**Honorable William J. Martini** **Civil Action No. 2:10-cv-01655-WJM-MF** **SECOND AMENDED CLASS ACTION COMPLAINT AND JURY DEMAND**

John Hancock Life Insurance
Company (U.S.A.), and the
participants and beneficiaries
of all such ERISA covered
employee benefit plans; and
DANIELLE SANTOMENNO
individually and on behalf of any
person or entity that is a party
to, or has acquired rights, under,
an individual or group variable
annuity contract that was
issued/sold by John Hancock Life
Insurance Company (U.S.A.)

* * *

[50] **B. Expenses Ratio Fee**

202. Defendant John Hancock (U.S.A.) charges Plaintiffs a fee for their investments into the Sub-Accounts, called the Expense Ratio ("ER").

203. Defendant John Hancock (U.S.A.) describes the ER as follows:

> These fees pay for the cost of running the Fund [i.e., the investment option]. The Expense Ratio may be comprised of the following components: Fund Expense Ratio [i.e., expense charged by the underlying mutual fund], Administrative Maintenance Charge, Sales and Service Fee, etc. This information is available on the Fund Sheets.

204. The ER, as presented to Plaintiffs on the Fund Sheets available online and in the 2008 and 2009 versions of the booklet entitled Your Investment

Options, is the sum of three fees: (A) the "FER," (B) the "AMC," and (C) and the "Sales and Service Fee." According to both versions of the booklet entitled Your Investment Options, the ER "does not include any contract level or participant recordkeeping charges."

205. The "FER" is described by Defendant John Hancock (U.S.A.) as the underlying fund's total expense ratio.

206. The "AMC" is described by Defendant John Hancock (U.S.A.) as John Hancock (U.S.A.)'s administrative maintenance charge.

* * *

[202] **JH MONEY MARKET INVESTMENT OPTION**

Fees:

Sub-Account	Underlying JH Fund
(09/09)	**JHOXX (05/09)**
FER: .58%	Mgt. Fee: .47%
AMC: .00%	12b-1 Fees: .05%
S&S: .50%	Other Expenses: .06%
ER: 1.08%	Tot. Exp.: .58%
(12/07)	**JHOXX (eff. 12/07)**
FER: .56%	Mgt. Fee: .48%
AMC: .00%	12b-1 Fees: .05%
S&S: .50%	Other Expenses: .03%
ER: 1.06%	Tot. Exp.: 056%
	Contract. Reimb. Exp.: .01%
	Net. Exp.: .55%

* * *

[207] THE GROWTH FUND OF AMERICA INVESTMENT OPTION

Fees:

Sub-Account	Class Chosen by JH	Appropriate Class
(9/09)	**Fund (Class R5) (eff. 11/09) (Ticker: RGAFX)**	**Fund (Class R6) (eff. 11/09) (Ticker: RGAGX)**
FER: .37%	Mgt. Fee: .28%	Mgt Fee: .28%
AMC: .45%	12b-1 Fees: .00%	12b-1 Fees: .00%
S&S: .50%	Other Exp.: .12%	Other Exp.: .09%
BR: 1.32%	Tot. Exp.: .40% (No front end sales)	Tot. Exp. .37% (No front end sales)
(12/07)	**Fund (Class R3) (eff. 11/07) (Ticker: RGACX)**	**Fund (Class R5) (eff. 11/07) (Ticker: RGAFX)**
FER: .93%	Mgt. Fee: .27%	Mgt Feet: .27%
AMC: .00%	12b-1 Fees: .50%	12b-1 Fees: .00%
S&S: .50%	Other Exp.: .19%	Other Exp.: .11%
ER: 1.43%	Tot. Exp.: .96% (No front end sales)	Tot. Exp. .38% (No front and sales)

Performance:

Total Return

Class R3	**Class R5**	**Class R6**[14]
8/31/09: -17.78%	8/31/09: -17.30	5/1-8/31/09: 15.17%
8/31/08: -8.50%	8/31/08: -7.96%	
8/31/07: 16.33%	8/31/07: 16.97%	
8/31/06: 9.30%	8/31/06: 9.92%	
8/31/05: 20.83%	8/31/05: 21.52%	
8/31/04: 8.28%	8/31/04: 9.02%	

[14] Class commenced operation on May 1, 2009.

Protecting Investors: A Half Century of Investment Company Regulation

[SEAL]

Division of Investment Management
United States Securities and Exchange Commission

May 1992

This is a report of the Division of Investment Management. The Commission has expressed no view regarding the analysis, findings, or conclusions herein.

* * *

In many respects, the variable annuity separate account operates much like a mutual fund during the contract's pay-in phase. As a result, the Division and other commenters have questioned whether variable annuity issuers should be permitted to deduct asset-based charges (like risk charges) on a basis that is different from that required of mutual funds.[115]

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[115] *See* Executive Summary, Letter of Investment Company Institute to Jonathan G. Katz, Secretary, SEC 10-11 (Sept. 19, 1988), File No. S7-10-88 (responding to Payment of Asset-Based Sales Loads by Registered Open-End Management Investment Companies, Investment Company Act Release No. 16431 (June 8, 1988), 53 FR 23258) (claiming competitive disadvantage to mutual funds in relation to variable insurance products because of different treatment of rule 12b-1 fees and risk charges).