No. 12-3

IN THE

Supreme Court of the United States

JACKIE HOSANG LAWSON
AND JONATHAN M. ZANG,

Petitioners,

v.

FMR LLC, ET AL.,

Respondents.

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

BRIEF OF *AMICUS CURIAE* INVESTMENT COMPANY INSTITUTE IN SUPPORT OF RESPONDENTS

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INTEREST OF THE *AMICUS*[1]

The Investment Company Institute ("ICI") is the national association of registered investment companies in the United States. ICI has three core missions: (1) encouraging adherence to high ethical standards by all industry participants; (2) advancing the interests of investment companies and their shareholders, directors, and investment advisers; and (3) promoting public understanding of registered open-end management investment companies ("mutual funds") and other registered investment companies. As part of its mission to promote public understanding of mutual funds, ICI pursues an extensive research program and is the primary source of aggregate industry data relied on by government regulators, industry participants, and independent observers. As of August 2013, ICI's members manage total assets of $15.2 trillion and serve more than 90 million shareholders in the United States.

Petitioners imply that mutual fund investors will be unprotected from fraud unless the Court extends the statutory language of section 806 of the Sarbanes-Oxley Act of 2002 ("SOX"), codified at 18 U.S.C. § 1514A, to cover private company employees. Indeed, one of Petitioners' amici goes so far as to claim that "a catastrophe in the mutual fund indus-

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[1] No counsel for any party has authored this brief in whole or in part, and no party or counsel for a party has made a monetary contribution to the preparation or submission of this brief. *See* Sup. Ct. R. 37.6. All parties have been timely notified of the undersigned's intent to file this brief; both parties have filed a blanket consent with the Court to the filing of all *amicus* briefs.

try," similar to the Enron scandal, may occur unless the Court stretches section 1514A to cover private company employees. The ICI recognizes and appreciates the importance of protecting corporate whistleblowers, but we disagree with both views and find them simply insupportable.

SUMMARY OF THE ARGUMENT

Petitioners strongly imply, and their amici explicitly claim, that the failure to extend section 1514A to cover private company employees "violates the clear Congressional intent to address the wrongs brought to light from Enron and Arthur Anderson and could lead to a similar disaster in the mutual fund industry."[2] This ignores not only the comprehensive regulation of the mutual fund industry and the important roles of fund boards of directors ("boards"), including their independent directors, and chief compliance officers ("CCOs"), but also Congress' more recent actions to protect whistleblowers through the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, 124 Stat. 1376 ("Dodd-Frank Act"). The Court should disregard Petitioners' and

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[2] Brief of *Amicus Curiae* National Employment Lawyers Association and Government Accountability Project in Support of Petitioners at 20, *Lawson v. FMR LLC*, No. 12-3 (Aug. 7, 2013); *see also* Brief for Petitioners at 53-61, *Lawson v. FMR LLC*, No. 12-3 (July 31, 2013) (detailing the events and commentary associated with the Enron and Arthur Anderson scandals and speculating about both (i) the connection between those events and section 1514A, and (ii) the results of the First Circuit's interpretation of section 1514A had it been in effect prior to the collapse of Enron).

their amici's unfounded rhetoric and focus on the statutory construction of section 1514A in resolving this case.

Mutual funds operate under a regulatory regime arguably more comprehensive than that governing any other financial product. This regulatory regime includes the Investment Company Act of 1940, as amended ("1940 Act"), and the Investment Advisers Act of 1940, as amended ("Advisers Act"), as well as other federal securities laws and the related regulations of the U.S. Securities and Exchange Commission ("SEC" or "Commission"). Given the breadth, comprehensiveness, and long-standing coherence of this regulatory structure, the argument that, to protect investors and prevent financial crises, it is necessary to extend section 1514A beyond the public company context for which it was enacted is simply hyperbole that must be rejected.

It is true that mutual funds characteristically are externally managed. Each fund, however, has a board that includes independent directors to oversee fund compliance with the federal securities laws. Independent directors, who, with rare exception, comprise a majority of mutual fund boards, are recognized as funds' independent "watchdogs" and serve to balance potential conflicts of interest between funds and their investment advisers. Fund CCOs assist the board and the independent directors in performing these functions. Congress and the courts are well aware of this structure and repeatedly have recognized the important role that boards and independent directors play in overseeing fund compliance with the

federal securities laws and the protection of mutual fund shareholders.

The ICI recognizes and appreciates the importance of protecting corporate employees against retaliation by their employers. The Court should recognize, however, that employees of investment advisers are affirmatively incented to "blow the whistle" on suspected securities violations and are protected from retaliation by provisions in the recently-enacted Dodd-Frank Act that apply expressly in the mutual fund and investment adviser context. Given these explicit protections that Congress has mandated, there is no reason to do violence to the plain language of section 1514A by extending its protections beyond those public company employees it was intended to protect. This is particularly true in the context of mutual funds and investment advisers, which are subject to a strong and comprehensive regulatory regime that was deliberately designed to protect investors. If Congress had intended that result, it would have done so expressly.

For these reasons, the judgment of the Court of Appeals for the First Circuit should be affirmed.

ARGUMENT

Drawing on the ICI's unique perspective and particular expertise, the purpose of this brief is to (1) illustrate the robust and comprehensive protections mutual fund shareholders enjoy; (2) explain the role that fund boards, independent directors and CCOs play in overseeing funds' compliance with applicable law; and (3) identify the whistleblower protections under recently-enacted legislation afforded

to those who report violations of the federal securities laws to the SEC, including the employees of private contractors, such as investment advisers to mutual funds. Together, these provisions demonstrate that the protection of mutual fund investors from fraud does not depend, as Petitioners and their amici contend, on the extension of section 1514A to private company employees.

A. The Federal Securities Laws Provide Comprehensive Protection for Mutual Fund Investors.

Mutual funds operate under a regulatory regime arguably more comprehensive than that governing any other financial product. Mutual fund investors are protected from potential abuses, conflicts of interest, fraud and other wrongdoing by numerous provisions of the extensive, interconnected regulatory regime imposed by the 1940 Act, the Advisers Act, and other federal securities laws, as well as by the detailed rules enacted by the SEC.[3] For example:

- 1940 Act rule 38a-1,[4] discussed in greater detail below, requires mutual funds to designate CCOs and adopt and implement compliance policies and procedures designed to ensure

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[3] *See, e.g.*, SEC, *Public Policy Implications of Investment Company Growth*, H.R. Doc. No. 89-2337, at 59-63 (1966) ("1966 Report") (explaining how each of the federal securities laws interacts with the mutual fund industry and how they, together with the 1940 Act, "establish significant regulatory controls over the investment company industry").

[4] 17 C.F.R. § 270.38a-1.

compliance with the federal securities laws (including policies and procedures that provide for the oversight of compliance by each investment adviser and certain other service providers to a mutual fund). The rule also requires that the CCO review the adequacy of the policies and procedures of the fund and of each applicable service provider and the effectiveness of their implementation at least annually and submit a written report to the board with the findings;

- Advisers Act rule 206(4)-7[5] requires investment advisers registered with the Commission to adopt and implement policies and procedures designed to prevent violations of the Advisers Act and the rules thereunder, review annually the adequacy of such policies and procedures and the effectiveness of their implementation, and designate a CCO responsible for administering such policies and procedures;

- Advisers Act rule 206(4)-8[6] prohibits fraudulent activities by investment advisers – untrue statements of material fact; omissions to state a material fact necessary to make the statements not misleading; otherwise engaging in any act, practice, or course of business that is fraudulent, deceptive or manipulative – with respect to investors or prospective investors in

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[5] 17 C.F.R. § 275.206(4)-7.

[6] *Id.* at § 275.206(4)-8.

pooled investment vehicles (including mutual funds) that the adviser advises;

- Section 15(a) of the 1940 Act[7] requires that a mutual fund's board of directors review and approve annually the investment adviser's management contract with the fund; and

- 1940 Act rule 17j-1[8] requires, among other things, that each mutual fund (with limited exceptions), and each investment adviser of and principal underwriter for the fund, adopt a written code of ethics designed to prevent certain enumerated fraudulent activities in connection with the purchase or sale of securities for the fund's portfolio.

These examples only begin to highlight the numerous and comprehensive protections mutual funds and their shareholders enjoy under the federal securities laws.

B. Mutual Fund Boards and Independent Directors, with the Assistance of Fund CCOs, Oversee Compliance with the Federal Securities Laws.

Petitioners contend that, because the fund has no employees of its own, only the employees of a mutual fund's investment adviser could be aware of vi-

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[7] 1940 Act § 15(a) (15 U.S.C. § 80a-15(a) (2012)).

[8] 17 C.F.R. § 270.17j-1.

olations.[9] This argument ignores the important role that boards, independent directors, and CCOs play in protecting the interests of funds and their shareholders.

The external management model, where the fund is managed by an investment adviser engaged for professional portfolio management and related services, predominates in the mutual fund industry.[10] The practice of external management of mutual funds "is one of long standing and was firmly imbedded in the industry at the time that the [1940 Act] was under consideration."[11] Indeed, the Court has recently acknowledged the structural distinctness of mutual funds and their advisers.[12]

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[9] Brief for Petitioners at 39-40, *Lawson v. FMR LLC*, No. 12-3 (July 31, 2013).

[10] *See, e.g.*, Compliance Programs of Investment Companies and Investment Advisers, Investment Company Act Release No. 26,299, Investment Advisers Act Release No. 2204, 68 Fed. Reg. 74,714, 74,722 (Dec. 24, 2003) ("Compliance Programs of Investment Companies and Investment Advisers ") ("[f]unds today typically have no employees, and delegate management and administrative functions . . . to one or more service providers"). We are aware of only one internally-managed mutual fund in the United States. There are a relatively small number of closed-end funds that are internally managed and that do have employees of their own.

[11] 1966 Report at 49.

[12] *See Janus Capital Group v. First Derivative Traders*, 564 U.S. ___, 131 S. Ct. 2296, 2299, 2304 (2011) (noting that although the investment adviser in that case created the relevant mutual fund, the fund "is a separate legal entity owned entirely by mutual fund investors" and that the Court "decline[d] . . . to disregard [such] corporate form").

The external management model presents the potential for certain conflicts of interest, as the Court also has recognized.[13] In considering and enacting the 1940 Act, mindful of this potential,[14] Congress required that at least 40% of a mutual fund's board of directors be independent,[15] and assigned to those independent directors "a host of special responsibilities involving supervision of management and financial auditing."[16]

Regulatory action by the SEC further enhanced the independence and effectiveness of mutual fund boards as checks on potential conflicts of interest inherent in the external management structure.[17] As a result of these regulatory changes, virtually all mutual funds now have, among other things, boards that are composed of at least a majority of independent directors and independent directors that must

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[13] *See, e.g.*, *Burks v. Lasker*, 441 U.S. 471, 481 (1979).

[14] *Id.* at 480-81; *see generally* S. Rep. No. 76-1775 (1940).

[15] A mutual fund director is independent if he or she is not an "interested person" of the fund, as that term is defined in the 1940 Act. *See* 15 U.S.C. § 80a-2(a)(19); *see also Burks*, 441 U.S. at 482 (explaining that, in 1970, "Congress amended the [1940] Act to strengthen further the independence of these directors adding the stricter requirement that the outside directors not be 'interested persons'").

[16] *Burks*, 441 U.S. at 482-83.

[17] Role of Independent Directors of Investment Companies, Securities Act Release No. 7932, Exchange Act Release No. 43,786, Investment Company Act Release No. 24,816, 66 Fed. Reg. 3734 (Jan. 16, 2001) ("Role of Independent Directors of Investment Companies").

be selected and nominated by other independent directors.[18]

The Court has recognized that a fund's independent directors serve as "independent watchdogs" who "'furnish an independent check upon the management' of investment companies."[19] Independent directors are responsible for, among other things, reviewing and approving the continuation of a mutual fund's advisory and underwriting contracts and selecting the fund's auditors who review the fund's financial statements and disclosures.[20] Moreover, a

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[18] This regulatory change was accomplished by conditioning reliance upon any of 10 rules, each of which exempts the fund from certain stringent requirements and upon which nearly all funds rely, on the fund's board meeting the enhanced independence requirements. *See id.* According to our most recent survey, as of year-end 2012, independent directors made up three-quarters of boards in 85 percent of fund complexes, nearly two-thirds of fund complexes have an independent board chair and more than nine in ten have separate legal counsel to serve their independent directors. *See* INVESTMENT COMPANY INSTITUTE & INDEPENDENT DIRECTORS COUNCIL, *Overview of Fund Governance Practices, 1994 – 2012* (2013).

[19] *Burks*, 441 U.S. at 484 (quoting *Tannenbaum v. Zeller*, 552 F.2d 402, 406 (2d Cir. 1976) and Hearings on H.R. 10065 before a Subcommittee of the H. Comm. on Interstate and Foreign Commerce, 76th Cong., 3d Sess., 109 (1940)); *see also Jones v. Harris Assocs.*, 559 U.S. 335, 348 (2010) ("The [1940] Act interposes disinterested directors as 'independent watchdogs' of the relationship between a mutual fund and its adviser"); *cf.* 1966 Report at 67 ("The [1940] Act sought to check the theretofore virtually unrestricted power of management groups by imposing specific requirements with respect to the composition of the boards of directors of investment companies").

[20] *Burks*, 441 U.S. at 483.

mutual fund's board, including its independent directors, has "broad responsibilities to monitor compliance with securities, corporate and other laws,"[21] and fund directors, including independent directors, owe fiduciary duties to the fund.[22]

In order to assist the board and the independent directors, mutual fund CCOs serve as the "eyes and ears of the board on matters of compliance."[23] Indeed,

> rule 38a-1 [of the 1940 Act] provides fund boards with direct access to a single person with overall compliance responsibility for the fund who answers directly to the board. The rule provides the board with a powerful tool to exercise its oversight responsibilities over fund compliance matters. . . . [The CCO is] responsible for keeping the board apprised of significant compliance events at the fund or its service providers . . . .[24]

Rule 38a-1 requires a fund's CCO to report directly to the fund's board. The designation and com-

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[21] Role of Independent Directors of Investment Companies, at 3735 n.6.

[22] 1940 Act § 36(a) (15 U.S.C. § 80a-35(a) (2012)).

[23] William H. Donaldson, Chairman, SEC, Remarks before the Mutual Fund and Investment Management Conference (Mar. 14, 2005).

[24] Compliance Programs of Investment Companies and Investment Advisers, at 74,722; *see also* 17 C.F.R. § 270.38a-1.

pensation of a fund's CCO must be approved by the fund board, and only the board, including a majority of the independent directors, has the authority to remove the CCO.[25]

Against this backdrop, it is clear that each mutual fund, even without employees of its own, has a set of responsible individuals who play a role in promoting and overseeing the fund's compliance with all applicable laws. To claim, as the Petitioners do,[26] that only the employees of a mutual fund's investment adviser would be aware of violations because the fund has no employees of its own is to ignore these structural safeguards, which have served effectively to protect the interests of funds and their shareholders.

C. Employees of Investment Advisers to Mutual Funds are Incented to "Blow the Whistle" on Suspected Securities Violations and Protected from Retaliation.

Protecting whistleblowers from retaliation plays an important role in the existing regulatory scheme. Contrary to Petitioners' assertions, declining to do violence to the plain language of section 1514A by extending its protections beyond their intended reach to cover the employees of private contractors of mutual funds does not, in the instant case

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[25] 17 C.F.R. § 270.38a-1(a)(4); *see also* Compliance Programs of Investment Companies and Investment Advisers.

[26] Brief for Petitioners at 39-40, *Lawson v. FMR LLC*, No. 12-3 (July 31, 2013).

or any other, mean that "no one would actually be protected from retaliation."[27] This claim wholly ignores recently enacted federal legislation that was explicitly incorporated into the 1940 Act and the Advisers Act.

As part of the Dodd-Frank Act, enacted in response to the recent financial crisis, Congress amended the Securities Exchange Act of 1934, ch. 404, 48 Stat. 881 (15 U.S.C. §§ 78a *et seq*.) ("Exchange Act") to include new section 21F, "Securities Whistleblower Incentives and Protection."[28] In doing so, Congress directly addressed any perceived gap in whistleblower protection in the mutual fund context. Pursuant to section 21F, whistleblowers who voluntarily provide the SEC with original information concerning securities law violations that leads to successful SEC enforcement proceedings may be eligible for monetary awards.[29] This has provided a significant incentive for whistleblowers to come forward.

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[27] *Id*. at 40.

[28] Pub. L. No. 111-203, § 922(a), 124 Stat. 1841 (2010).

[29] *See* Exchange Act § 21F(b)(1) (15 U.S.C. § 78u-6(b)(1)) ("In any covered judicial or administrative action, or related action, the Commission . . . shall pay an award or awards to 1 or more whistleblowers who voluntarily provided original information to the Commission that led to the successful enforcement of the covered judicial or administrative action, or related action . . . ."); Securities Whistleblower Incentives and Protections, Exchange Act Release No. 64,545, 76 Fed. Reg. 34,300 (June 13, 2011) ("Securities Whistleblower Incentives and Protections") ("The Dodd-Frank [Act] established a whistleblower program that requires the Commission to pay an award, under regulations prescribed by the Commission and subject to certain limitations, to eligible whistleblowers . . . .").

Indeed, the SEC just announced an award of more than $14 million – the largest made by the SEC's whistleblower program to date – to a whistleblower whose information led to an SEC enforcement action that recovered substantial investor funds.[30]

Moreover, section 21F(h)(1) explicitly prohibits retaliation by employers against whistleblowers. It provides that:

> (A) No employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower –
>
> (i) In providing information to the Commission in accordance with this section;
>
> (ii) In initiating, testifying in, or assisting in any investigation or judicial or administrative action of the Commission

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[30] In the Matter of the Claim for Award: Order Determining Whistleblower Award Claim, Exchange Act Release No. 70,554 (Sept. 30, 2013); *see also SEC Awards More Than $14 Million to Whistleblower*, SEC Press Release No. 2013-209 (Oct. 1, 2013). In commenting on this award, SEC Chair Mary Jo White stated, "Our whistleblower program already has had a big impact on our investigations by providing us with high quality, meaningful tips." SEC Press Release No. 2013-209.

> based upon or related to such information; or
>
> (iii) In making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002 . . . , the Securities Exchange Act of 1934 . . . , and any other law, rule, or regulation subject to the jurisdiction of the Commission."[31]

This broad prohibition against retaliation is accompanied by a statutory private right of action that can result in a reinstatement of a whistleblower's employment with the same status as the individual would have had absent the discrimination, two times back pay plus interest, and compensation for litigation costs, expert witness fees, and reasonable attorneys' fees.[32]

Congress amended both the 1940 Act and the Advisers Act to incorporate the Dodd-Frank whistleblower protections, demonstrating Congressional intent that those protections be available in the context of mutual funds and their investment advisers. Specifically, Dodd-Frank sections 923(a)(2) and (a)(3) amended the 1940 Act and Advisers Act provisions concerning the payment of penalties imposed under the 1940 Act and Advisers Act, respectively, to recognize penalties pursuant to the Exchange Act section 21F protections. In each case, the statute was amended to provide that "[a] penalty imposed under

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[31] Exchange Act § 21F(h)(1)(A) (15 U.S.C. § 78u-6(h)(1)(A)).

[32] *Id.* at § 21F(h)(1)(C) (15 U.S.C. § 78u-6(h)(1)(C)).

this section shall be payable into the Treasury of the United States except as otherwise provided in section 308 of the Sarbanes-Oxley Act of 2002 *and section 21F of the Securities Exchange Act of 1934*."[33] This stands in sharp contrast to section 1514A. Unlike unrelated SOX section 308, section 1514A was not accompanied by any corresponding amendment to the 1940 Act or the Advisers Act; nor did Congress amend section 1514A to extend its protections to private company whistleblowers when it considered whistleblower protections as part of the Dodd-Frank Act. Thus, whereas the Dodd-Frank Act clearly contemplates whistleblowing by employees of investment advisers (and expressly protects them from retaliation), section 1514A does not.

In implementing the Dodd-Frank whistleblower protection provisions, the SEC has included investment advisers (and investment adviser representatives), mutual funds and, more broadly, both privately held and publicly held companies among the entities against which complaints could be made.[34] Specifically, the SEC developed a form – Form TCR – for use by whistleblowers in notifying the Commission of a tip, complaint, or referral regarding potential securities law violations.[35] The form calls for a description of the "individual or entity

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[33] 1940 Act § 42(e)(3)(A) (15 U.S.C. § 80a-41(e)(3)(A) (2012)) (emphasis added); Advisers Act § 209(e)(3)(A) (15 U.S.C. § 80b-9(e)(3)(A) (2012)) (emphasis added); *see* Dodd-Frank Act §§ 923(a)(2) and (a)(3), 124 Stat. 1850 (2010).

[34] *See* Securities Whistleblower Incentives and Protections.

[35] *See* SEC Form TCR.

you have a complaint against"; the form's instructions explain that for these questions, one is to choose among a list of possible individuals and entities to which the complaint relates, which list includes "investment advisor, investment advisor representative, investment company, . . . mutual fund, . . . private/closely held company, [and] publicly held company."[36]

The whistleblower protections adopted by the SEC pursuant to the Dodd-Frank Act play an important role in the mutual fund regulatory scheme. In light of these protections, Petitioners' claim that declining to stretch section 1514A beyond the public company context would result in whistleblowers in the mutual fund industry being entirely unprotected from retaliation is unpersuasive and should be rejected.

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[36] *Id.* at Instructions: Section C, Question 1.

CONCLUSION

Petitioners strongly imply, and their amici explicitly argue, that the failure to extend section 1514A to cover private company employees will leave mutual fund investors unprotected and may result in a catastrophe in the mutual fund industry akin to the Enron and Arthur Anderson scandals. We disagree with both assertions and find them simply insupportable.

Mutual funds and their investment advisers operate under a comprehensive, coherent, and highly integrated regulatory regime that has benefited and protected investors for over seventy years. Each fund, even without employees of its own, has a set of responsible individuals who play a role in promoting and overseeing the fund's compliance with all applicable laws. Moreover, recently-enacted federal whistleblower protection legislation, which, unlike section 1514A, was explicitly incorporated into the 1940 Act and the Advisers Act, protects employees of mutual fund investment advisers.

Thus, the fact that section 1514A's protections for public company employee whistleblowers do not extend to the employees of private contractors to mutual funds has little bearing or impact on the protections that mutual fund investors enjoy or on the ability to prevent future crises in the mutual fund industry. The Court should disregard Petitioners' and their amici's unfounded rhetoric and focus on the statutory construction of section 1514A in resolving this case.

For all the reasons set forth herein, the judgment of the Court of Appeals for the First Circuit should be affirmed.

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