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November 21, 2005

Honorable Christopher Cox
Chairman
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-2001

Dear Chairman Cox:

The Committee on Investment Management Regulation of The Association of the Bar of the City of New York is composed of lawyers with diverse perspectives on investment management issues, including members of law firms, and counsel to financial services firms, investment company complexes and investment advisers. A list of our current members is enclosed.

We are writing to urge the Commission to file a brief *amicus curiae* in a case pending in the United States District Court for the Southern District of New York entitled *J. & W. Seligman & Co. Incorporated v. Eliot Spitzer*, No. 05 Civ. 7781 (S.D.N.Y. filed Sept. 6, 2005) (*"Seligman"*).

Plaintiff in Seligman is an investment adviser registered with the Commission pursuant to the Investment Advisers Act of 1940. Defendant Spitzer is the Attorney General for the State of New York ("NYAG"). The NYAG, together with the Commission, commenced an investigation of Seligman in February 2004 arising from alleged frequent trading by certain customers in certain mutual funds managed by Seligman. (Compl. 9.) In its Complaint, Seligman seeks to

enjoin the NYAG from investigating or requesting information concerning allegedly excessive advisory fees paid to Seligman or otherwise exercising powers delegated by Congress to the Commission under Section 36(b) of the Investment Company Act of 1940 ("ICA"). (A copy of the *Seligman* complaint is enclosed.)

On October 3, 2005, the NYAG filed a motion to dismiss the Complaint on two grounds: (1) that federal courts should abstain from interfering with ongoing state proceedings; and (2) that the ICA does not preempt state law fraud claims involving advisory fees such as those asserted by the NYAG against Seligman. (A copy of the NYAG's memorandum in support of its motion to dismiss is enclosed.)

We do not address the merits of the case, nor do we question the authority of state regulators to pursue issues of fraud. We write solely to respectfully suggest that the Commission file a brief *amicus curiae* at this stage of the *Seligman* District Court proceeding to articulate the scope of state regulators' authority under the ICA and the National Securities Markets Improvement Act of 1996 ("NSMIA") to investigate and litigate advisory fee issues.

We recognize that it is unusual for the Commission to file an *amicus* brief at the District Court level. However, we believe that this is an unusual case. The issues concerning the Commission's authority to regulate investment advisory fees, and the extent to which state regulators share that authority, are legal issues that will be addressed at the outset of the case. No factual issues need to be developed or resolved. If the Commission does not participate in the case in the District Court at this stage, it may have to wait years before the issues are again presented to a District Court or to a Court of Appeals, as cases such as this are generally settled or otherwise resolved in a manner that will preclude the Commission from ever having an opportunity to address the issues.

We believe a brief *amicus curiae* from the Commission would be useful in three respects.

First, the Commission should explain that state regulators may not bring a claim under Section 36(b) of the ICA. Section 36(b) expressly provides that only the Commission or a security holder of a registered investment company may bring a claim for breach of fiduciary duty with respect to the receipt of advisory compensation. *See* 15 U.S.C. § 80a-35(b). To the extent that state regulators seek to control the amount of Seligman's advisory fees, this would appear to be infringing upon an area that Congress has specifically charged the Commission with enforcing.

Second, the Commission should explain the importance of the ICA's statutory scheme of annual review and approval of a fund's advisory agreement by a majority of the fund board's independent directors. The District Court would almost certainly find an explanation of this statutory scheme by the Commission helpful in understanding the issues.

Third, and perhaps most important, attempts by state regulators to control the level of advisory fees appears to contradict both the legislative history and the Commission's own stated interpretation of NSMIA. As the Commission has previously explained, NSMIA was prompted

by Congress' concern "with the cost imposed on investment advisers and their clients by overlapping, and in some cases, duplicative regulation" by states. *Rules Implementing Amendments to the Investment Advisers Act of 1940*, Commission Release No. IA-1633, File No. S7-31-96, at 7 (May 15, 1997) ("Final Rules Release"). *See also* S. Rep. No. 104-293 at 2 (1996) (in enacting NSMIA, Congress stated that it was amending the ICA and other federal securities statutes "to delineate more clearly the securities law responsibilities of the federal and state government" which currently overlapped).

Through NSMIA, then, the Commission noted that "Congress intended to reduce those burdens by subjecting large advisers to a single regulatory program administered by" the Commission – not by state regulators. Final Rules Release at 8. Accordingly, NSMIA "gives the *Commission* primary responsibility to regulate advisers that remain registered with the Commission by preempting state regulation of those advisers." *Id.* at 68 (emphasis added). *See also* S. Rep. 104-293 at 6 (1996) (Congress proposed to have "exclusive federal review" of investment company registration since "the SEC already comprehensively regulates investment companies under the disclosure provisions of the Securities Act and the substantive regulatory provisions of the Investment Company Act").

In the Final Rules Release, the Commission reiterated its view that the "structure and design" of NSMIA's new Section 203A(b) of the Investment Advisers Act "suggest Congress intended to broadly preempt state investment adviser law." *Id.* at 72. Thus, the Commission stated that Section 203A(b) "preempts not only a state's specific registration, licensing, or qualification requirements, but *all* regulatory requirements imposed by state law on Commission-registered advisers relating to their advisory activities or services, *except* those provisions that are specifically preserved" by NSMIA. *Id.* at 69 (emphasis added). The Commission further noted that "[o]n its face, Section 203A(b)(2) preserves *only* a state's authority to investigate and bring enforcement actions under its anti-fraud laws with respect to Commission-registered advisers." *Id.* at 74 (emphasis added).

The Commission noted that in its Proposing Release, it interpreted Section 203A(b)(2) "as precluding a state from indirectly regulating the activities of Commission-registered advisers by applying state requirements that define 'dishonest' or 'unethical' business practices unless the prohibited practices would be fraudulent or deceptive absent the requirements." *Id.* at 73. While state regulators took "strong exception" to that interpretation, the Commission's Final Rules Release reaffirmed that it "does not believe that [NSMIA] can be read to preserve such state regulatory authority over Commission-registered advisers." *Id. See also* S. Rep. 104-293 at 6 (1996) (the Senate Committee "does not intend for the 'policing' authority [over fraud] to provide states with a means to undo the state preemption of investment company registration").

In short, the Commission has expressed its view of NSMIA's broad preemption of state regulation of investment advisers and its narrow exemption for fraud actions. In the *Seligman* action, while no one would dispute that the NYAG has authority to investigate Seligman's alleged fraud, the Commission may well conclude that NSMIA appears to preempt any state regulation of advisory fees in the absence of fraud or deceit. Such state regulation of advisory fees appears to be inconsistent with the Commission's expressed views and could lead to

difficult, cumbersome, and potentially conflicting state regulation of the level of investment advisory fees.

Consistent with the Commission's stated views regarding NSMIA's preemptive effect, then Chairman Donaldson has expressed strong concerns about the very issues presented by the *Seligman* case. In a November 18, 2003 op-ed piece in the *Wall Street Journal* Chairman Donaldson pointedly addressed criticisms that the Commission's settlement of its market timing case against the Putnam mutual-fund complex did not address how fees are charged and disclosed in the mutual fund industry. Chairman Donaldson wrote:

> The amount and disclosure of fees is not, and never has been, a part of the Putnam case, and thus it would be wholly improper to try to piggyback the fee-disclosure issue on an unrelated matter.
>
> If our continuing investigation of Putnam uncovers evidence of wrongdoing in the fee-disclosure area, we will not hesitate to act, and the Commission is already moving forward with rulemaking that will address this issue, and others, on an industry-wide basis. *Those lacking rulemaking authority seem to want to shoehorn the consideration of the fee-disclosure issues into the settlement of lawsuits about other subjects.* But we should not use the threat of civil or criminal prosecution to extract concessions that have nothing to do with the alleged violations of the law.

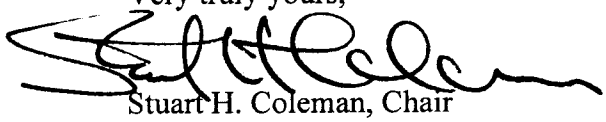
William H. Donaldson, "Investors First," *The Wall Street Journal*, November 18, 2003 at A20 (emphasis added). Filing an amicus brief in the Seligman case would provide the Commission with the opportunity to reiterate and articulate the position expressed by Chairman Donaldson.

For all of the above reasons, we urge the Commission to file a brief *amicus curiae* in the *Seligman* case.

Drafting Member

Mark Holland

Very truly yours,



Stuart H. Coleman, Chair

cc: Hon. Paul S. Atkins
Hon. Roel C. Campos
Hon. Cynthia A. Glassman
Hon. Annette L. Nazareth

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* Mr. Nasta is General Counsel of J. & W. Seligman & Co. Incorporated ("Seligman") and Mr. Baumgardner is counsel to non-interested Board members of investment companies advised by Seligman. Messrs. Nasta and Baumgardner did not participate in the preparation of this letter and did not review any draft before it was transmitted to the Commissioners.