No. 08-586

IN THE

Supreme Court of the United States

JERRY N. JONES, MARY F. JONES,
AND ARLINE WINERMAN,

Petitioners,

v.

HARRIS ASSOCIATES L.P.,

Respondent.

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

BRIEF FOR THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

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INTEREST OF *AMICUS CURIAE*[1]

The Chamber of Commerce of the United States of America (the "Chamber") is the world's largest business federation. The Chamber represents an underlying membership of more than three million companies and professional organizations of every size, in every industry sector, and from every region of the country. The Chamber represents the interests of its members in matters before Congress, the Executive Branch, and the courts. The Chamber regularly files *amicus* briefs in cases that, like this one, raise issues of vital concern to the nation's business community.

Members of the Chamber and their subsidiaries include investment advisers, some of whom unfortunately and unfairly have been sued as defendants under § 36(b) of the Investment Company Act of 1940 (the "ICA" or the "Act"), 15 U.S.C. § 80a (2006) for allegedly charging "excessive" fees for the work they do in managing mutual funds. Members of the Chamber also include investors in mutual funds governed by the Act. The Chamber thus is familiar

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[1] Pursuant to this Court's Rule 37.3(a), letters of consent from all parties to the filing of this brief are on file or have been submitted to the clerk.

Pursuant to Rule 37.6, *amicus curiae* affirms that no counsel for a party authored this brief in whole or in part, and no such counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than *amicus curiae,* its members or its counsel made a monetary contribution to its preparation or submission.

with the everyday norms and practices of the mutual fund industry, both from the perspective of investment advisers that are entitled to charge management fees for the services they provide, and from the perspective of investors, who understand that paying such management fees is part of the cost of investing in mutual funds.

The Chamber has a particular interest in this litigation because of its potential adverse effect on all participants in the mutual fund industry. Section 36(b) was enacted for one purpose: to enable mutual fund investors to recover the repayment of excessive management fees. It is not a vehicle for private plaintiffs to police the process by which investment advisory fees are set or to challenge a fund's disclosures regarding those fees. Other statutory provisions address process and disclosure issues; but these other provisions do not create the expansive private cause of action that petitioners would read into § 36(b). Section 36(b) should not be construed in a manner that would enable private plaintiffs to do precisely what Congress denied in other provisions.

Some have suggested that the Court use this case to send a message regarding executive compensation in corporate America. This Court's task is interpreting statutes, not "sending messages." If the federal government is going to get involved in regulating executive compensation, particularly for companies that are *not* receiving government assistance, that kind of radical departure (which the Chamber would vigorously oppose) must come from the elected legislative branch, not the judiciary. *See*

Eldred v. Ashcroft, 537 U.S. 186, 222 (2003) ("The wisdom of Congress' action, however, is not within our province to second-guess.").

SUMMARY OF ARGUMENT

This case is one of hundreds filed in recent years alleging that mutual fund advisers violated their fiduciary duties under § 36(b) of the Investment Company Act by supposedly charging "excessive fees" for their services and otherwise committing various wrongs. Petitioners are shareholders of three funds in the Oakmark "family" of mutual funds managed by respondent. Respondent earned fees for its services pursuant to a written agreement, the terms of which were vetted and approved by the funds' independent trustees and described in detail in the funds' public filings. Petitioners thus purchased their shares in arm's-length transactions after respondent's fee rates were fully disclosed.

Because there are thousands of funds in the highly competitive mutual fund market, petitioners were free to invest their money in other funds if they felt respondent's fees were too high. And after freely investing in the funds, petitioners were in no way prevented from redeeming their shares and investing their money elsewhere if they believed respondent's performance was sub-par. But like others who have jumped on the litigation bandwagon, petitioners instead seek to use § 36(b) to boost their returns after the fact, challenging the process by which respondent's fees were set and the disclosures the funds made regarding that process. In making that

claim, however, petitioners would have the Court construe § 36(b) in a way that is contrary to the clear language of the statute and the purpose Congress intended it to serve, and would lead to all manner of abuse.

First, the broad and amorphous scope of § 36(b) liability suggested by petitioners is inconsistent with the text and structure of the Investment Company Act and other provisions of the federal securities laws. The plain language of the statute, directed explicitly at an adviser's "receipt of compensation for services," precludes actions under § 36(b) for other and different wrongs. That is confirmed by § 36(b)'s legislative history. As that history shows, Congress envisioned that the process of setting fee rates was best left to the "business judgment" of mutual fund directors, who were to set fees with an eye toward "best industry practice," and without interference by shareholder litigations. Instead, any claim that the process by which management fees were set was improper is exclusively enforceable by the SEC under separate provisions of the Investment Company Act and the Investment Advisers Act of 1940 (the "Advisers Act"), not by private litigation under § 36(b). To be sure, private investors may bring claims against certain defendants alleging false and misleading disclosures in fund documents under the Securities Act of 1933 (the "1933 Act") and the Securities Exchange Act of 1934 (the "1934 Act"), but only to the extent investors actually purchased or sold securities based on those disclosures. To permit mere pre-existing holders of

mutual fund shares to sue for misleading disclosures under § 36(b), as petitioners' position implies, would allow them to circumvent the limits on private shareholder litigation in the 1933 and 1934 Acts. Nothing in the Investment Company Act or any of the other federal securities laws supports such a result.

Second, petitioners' approach to § 36(b) would lead to precisely the sorts of mischief Congress purposefully sought to avoid.

i. Congress was wary that § 36(b) could be abused by plaintiffs' lawyers, and reversed the burden of proof normally applicable in fiduciary cases to prevent that from happening. Unfortunately, Congress' concern that § 36(b) would generate strike suits by unscrupulous lawyers has proved all too well-founded. The practical reality is that, despite the overwhelming popularity of mutual funds among consumers, the level of "excessive fee" litigation has exploded in recent years. Using § 36(b) as a catch-all tool to remedy any type of alleged misdeeds or omissions, plaintiffs' lawyers have brought suits against advisers regardless of the level of disclosure of fee information, the level of management fees themselves, or the net return to fund investors at the end of the day. Indeed, even advisers who charge below-average fees, generate above-average returns, or both, have been named as § 36(b) defendants. The present case is no exception. Congress did not intend § 36(b) to be a boon for the plaintiffs' bar.

ii. Under petitioners' proposed standard, it would be unduly difficult for defendants to secure

dismissal of unmeritorious claims at the early stages of litigation. This is directly at odds with the plain language of § 36(b), which puts the burden squarely on plaintiffs to demonstrate that the adviser breached its fiduciary duty through the receipt of excessive fees, and would effectively force defendants to undergo costly discovery in all cases, no matter how weak.

iii. Petitioners' approach would create coercive pressure to settle even meritless suits and burden funds and their shareholders with unnecessary costs. This Court has repeatedly recognized the enormous burdens that discovery in securities cases entails and the settlement leverage such burdens unfairly generate.

iv. The highly expansive interpretation of § 36(b) advocated by petitioners would cause detrimental ripple effects throughout the industry, burdening advisers, funds and fund shareholders alike. Advisers that risk suit despite earning below average fees may simply opt against offering mutual funds, hampering competition and leaving investors with fewer mutual fund options. Moreover, the costs of defending such suits are not borne by advisers alone. Despite the fact that they are not party defendants, the funds are also subject to costly discovery in such suits, and may be contractually obligated to pay for the costs of the adviser's defense. Because mutual funds are nothing more than the pooled investments of their shareholders, the real losers are therefore investors, out of whose pockets the costs of abusive fee litigation ultimately come.

ARGUMENT

I. PETITIONERS' APPROACH IS CONTRARY TO THE TEXT AND STRUCTURE OF THE INVESTMENT COMPANY ACT AND OTHER PROVISIONS OF THE FEDERAL SECURITIES LAWS.

A. By Its Plain Terms, § 36(b) Does Not Provide A Private Right Of Action For Alleged Flaws In The Process By Which Management Fees Are Set.

Petitioners interpret the fiduciary duty in § 36(b) of the Investment Company Act to extend to the adviser's disclosure of information to the mutual fund's directors. (Pet. Br. at 17.) Under their proposed approach, an adviser would breach its fiduciary duty if the process by which the fee is set were flawed in some way, regardless of whether the fee actually agreed upon was "excessive" in any respect. This interpretation of § 36(b) is flatly belied by express terms of the statute and its legislative history.

Section 36(b) creates a "narrowly circumscribed right of action for damages." *Transamerica Mortgage Advisors, Inc. (TAMA) v. Lewis*, 444 U.S. 11, 22 n.13 (1979). Under its terms, § 36(b) creates a fiduciary duty only "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." 15 U.S.C. § 80a-35(b) (emphasis added). Likewise, no action may be brought under § 36(b) against anyone other than the "*recipient* of such compensation or payments." 15 U.S.C. § 80a-35(b)(3) (emphasis added). And any damages awarded against such a *recipient* as a result of such breach "shall in no event exceed the amount of compensation or payments *received*." *Id.* (emphasis added). Because both the duty created by § 36(b) and the relief it provides for any breach are expressly limited to the "receipt" of excessive compensation, there is simply no textual basis to read § 36(b) as creating a private cause of action for any other or different wrongs. *See, e.g., Migdal v. Rowe Price-Fleming Int'l., Inc.*, 248 F.3d 321, 328-329 (4th Cir. 2001) (§ 36(b) limited to the receipt of excessive fees; it does not provide a right of action for breaches of fiduciary duty governed by § 36(a)).

Moreover, the plain terms of § 36(b) are confirmed by its legislative history. As that history shows, Congress did not intend to create a private right of action under § 36(b) to correct alleged flaws in the compensation-setting process unless those procedural flaws caused the receipt of excessive payments. *See* H.R. Rep. No. 91-1382, at 37 (1970) (even fee deliberations that were "a mere formality . . . would not be controlling in determining whether or not the fee encompassed a breach of fiduciary

duty"); S. Rep. No. 91-184, at 15 (1969) (same). On the contrary, Congress envisioned that the process of setting fees was best left to the "business judgment" of mutual fund directors, who were to approve rates with an eye to "best industry practice" without interference by shareholder litigation.[2] *See* S. Rep. No. 91-184, at 6 (§ 36(b) "is not intended to authorize a court to substitute its business judgment for that of the mutual fund's board of directors"); *id.* ("the best industry practice will provide a guide"); 15 U.S.C. § 80a-15 (process for approval of management contracts); *see also In re Citigroup Inc. S'holder Deriv. Litig.*, 964 A.2d 106, 122 (Del. Ch. 2009) (the business judgment rule is designed to "prevent[] judicial second guessing" of director decisions) (internal quotations omitted). Congress meant § 36(b) to provide a private claim only if a certain outcome occurred -- the receipt of excessive fees -- not to police the process.

B. The Private Right Of Action Under § 36(b) Should Not Include Claims Based On Conduct Governed By § 15(c) Of The Act.

Congress was, of course, concerned with the process by which management fees are set, but opted to address that issue in § 15 of the Act -- not § 36(b) -- which governs the duties of fund directors in that

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[2] The Oakmark funds at issue here had trustees, rather than directors, but the terms are synonymous under the Act. *See* 15 U.S.C. § 80a-2(a)(12).

process. As this Court has previously acknowledged, "Congress' purpose in structuring the Act as it did is clear." *Burks v. Lasker*, 441 U.S. 471, 484 (1979). "It was designed to place the unaffiliated directors in the role of independent watchdogs," and give them "the *primary responsibility* for looking after the interests of the funds' shareholders." *Id.* at 484-85 (emphasis added; internal quotations omitted).

Under § 15 of the Act, no person shall serve as an investment adviser to a mutual fund except pursuant to a written contract that has been approved by a majority of the non-interested -- *i.e.*, independent -- members of the fund's board. *See* 15 U.S.C. §§ 80a-15(a), 80a-15(c), 80a-2(a)(19). Before they approve or renew an advisory contract, the directors are required under § 15(c) to request such "information as may reasonably be necessary to evaluate" its terms, and the adviser is under a "duty . . . to furnish [this] information[.]" *Id.* The SEC requires disclosure of the information the board considered in approving or renewing an advisory contract, including:

> [1] the nature, extent, and quality of the services to be provided by the investment adviser; [2] the investment performance of the fund and the investment adviser; [3] the costs of the services to be provided and profits to be realized by the investment adviser and its affiliates . . . [4] the extent to which economies of scale would be realized as the fund grows; and [5] whether fee levels reflect these

> economies of scale for the benefit of fund investors.

17 C.F.R. § 240.14a-101 (2009). No fee contract may be approved by the directors unless it "[p]recisely describes all compensation to be paid thereunder." 15 U.S.C. § 80a-15(a)(1).

The power to enforce compliance with § 15(c) resides exclusively with the SEC. *See* 15 U.S.C. § 80a-41 (providing for SEC enforcement of the Act). Nevertheless, according to petitioners' approach, the very conduct governed by § 15(c) could also form the basis of a private right of action for breach of fiduciary duty under § 36(b), the only private right of action expressly recognized under the Act. (*See* Pet. Br. at 11-12.) Under well-established rules of statutory interpretation, however, § 36(b) is clearly inapplicable to conduct regulated by the SEC under § 15(c).

Statutory construction is a "holistic endeavor." *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371 (1988). The "settled rule" is that the Court "must, if possible construe a statute to give every word some operative effect." *Cooper Indus., Inc. v. Aviall Servs., Inc.*, 543 U.S. 157, 167 (2004). Different parts of a statute must be read in conjunction with one another, so that none is interpreted in a way that renders another superfluous. *Corley v. United States*, 129 S. Ct. 1558, 1566 (2009) (a "statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant")

(internal quotations omitted). When legislation expressly provides a remedy or remedies, "courts should not expand the coverage of the statute to subsume other remedies." *Nat'l R.R. Passenger Corp. v. Nat'l Ass'n of R.R. Passengers*, 414 U.S. 453, 458 (1974). "This principle of statutory construction reflects an ancient maxim – expressio unius est exclusio alterius." *Id.*

Thus, when a statute provides for a private right of action for some but not all of its provisions, the scope of that private right will be construed narrowly. *See id.* at 457-458 (statute explicitly authorizing private suits in limited types of cases did not create a right to sue for causes of action arising under the act as a whole); *Alexander v. Sandoval*, 532 U.S. 275, 290 (2001) ("The express provision of one method of enforcing a substantive rule suggests that Congress intended to preclude others."); *Olmsted v. Pruco Life Ins. Co. of N.J.*, 283 F.3d 429, 433, 433 n.3 (2d Cir. 2002) (contrasting ICA § 36(b) with §§ 26(f) and 27(i) and stating that "Congress's explicit provision of a private right of action to enforce one section of a statute suggests that omission of an explicit private right to enforce other sections was intentional"). Indeed, a private right of action under a securities statute should not be construed to overlap with areas of enforcement specifically delegated exclusively to the SEC. *See, e.g.*, *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761, 771 (2008) (expanding the scope of the private right of action under § 10(b) of the Securities Exchange Act of 1934 to include claims specifically

made enforceable only by the SEC would "undermine Congress' determination that this class of defendants should be pursued by the SEC and not by private litigants").

Under these settled principles, therefore, the private right of action under § 36(b) of the Act does not include claims based on conduct governed by § 15(c). *See Green v. Nuveen Advisory Corp.*, 295 F.3d 738, 744 (7th Cir. 2002) (refusing to expand § 36(b) claim to include claims under other sections of the ICA or state law).

To hold otherwise would have the same effect as creating an implied private right of action under § 15(c), something this Court has emphatically "caution[ed] against." *See Stoneridge*, 128 S. Ct. at 772 ("[I]t is settled that there is an implied cause of action *only* if the underlying statute can be interpreted to disclose the intent to create one.") (emphasis added). Accordingly, no court that has considered the issue has held that a private right of action exists under § 15(c). *See, e.g., Gartenberg v. Merrill Lynch Asset Mgmt, Inc.*, 528 F. Supp. 1038, 1067 (S.D.N.Y. 1981) ("Sections 15(b), 15(c), and 20(a) of the Act were not intended to and do not establish a private right of action in the context of a claim such as here for recovery of compensation under Section 36(b). The structure of the Act makes clear that no private remedies other than Section 36(b) seeking restitution of advisory fees shall be implied, brought or maintained and no other relief shall be granted against the recipient of the payments made."), *aff'd*, 694 F.2d 923 (2d Cir. 1982); *Halligan v.*

Standard & Poor's/Intercapital, Inc., 434 F. Supp. 1082, 1084 (E.D.N.Y. 1977) ("Since § 36(b) affords a complete remedy for excessive fees paid to investment advisers, there is no need to imply a right of action under § 15(c). The duty created by § 15(c) can be enforced by the Securities and Exchange Commission"). Thus, alleged violations of § 15(c) should not be a permissible basis for a private party's claim under § 36(b).

C. The Private Right Of Action Under § 36(b) Should Likewise Not Include Claims Based On Conduct Governed By § 206 Of The Investment Advisers Act.

Petitioners' expansion of § 36(b) liability to reach alleged process violations would also improperly encroach upon § 206 of the Investment Advisers Act and the rules promulgated thereunder. Section 206(2) is a broad anti-fraud provision, which prohibits an investment adviser from engaging "in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client" and imposes on investment advisers a fiduciary duty to their clients to act in "utmost good faith," fully and fairly disclose all material facts, and use reasonable care to avoid misleading clients. *See* 15 U.S.C. § 80b-6(2); *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191, 194 (1963). Proof of scienter is not required to establish a violation of § 206(2). *Steadman v. SEC*, 603 F.2d 1126, 1134 (5th Cir. 1979), *aff'd* 450 U.S. 91

(1981); *see also* 17 C.F.R. § 275.206(4)-8(a)(1) (2009) (investment adviser may not make any "untrue statement of a material fact or [] omit to state a material fact necessary to make the statements made . . . not misleading, to any investor or prospective investor in the pooled investment vehicle").

Like that in § 15(c) of the Investment Company Act, the authority to enforce § 206 of the Investment Advisers Act and Rule 206(4)-8 rests exclusively with the SEC. *See* 15 U.S.C. § 80b-9; Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles, Investment Advisers Act of 1940 Release No. 2628, 72 Fed. Reg. 44,756, 44,760 (final rule adopted Aug. 9, 2007) (Rule 206(4)-8 "does not create a private right of action"). The SEC has exercised that authority, bringing actions against investment advisers who allegedly failed to provide sufficient information to mutual fund directors regarding management fees. *See, e.g., SEC v. Am. Birthright Trust Mgmt. Co.,* Litigation Release No. 9266, 21 SEC Docket 1241 (Dec. 30, 1980); *New York Life Inv. Mgmt. LLC*, Cease-and-Desist Order, Investment Advisers Act of 1940 Release No. 2883, Investment Company Act of 1940 Release No. 28,747 (May 27, 2009); *see also* U.S. Gen. Accounting Office, *Mutual Fund Fees: Additional Disclosure Could Encourage Price Competition*, at 93 (June 2000)[3] (citing instances uncovered by SEC examinations of deficiencies in directors' review of fees).

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[3] *Available at* http://www.gao.gov/archive/2000/gg00126.pdf

Section 36(b) should not be construed to include claims based on conduct governed by § 206 of the Investment Advisers Act. The two statutes comprise companion legislation whose provisions must be read together as part of a single regulatory scheme. *See Transamerica Mortgage*, 444 U.S. at 22 n.13 (construing the Investment Advisers Act in conjunction with the 1970 amendments to the Investment Company Act.) To allow a private right of action under § 36(b) for claims covered by § 206 would permit plaintiffs to effect an end-run around this Court's ruling in *Transamerica Mortgage* that no private right of action under § 206 exists. *Id.* at 24 ("we hold that there exists a limited private remedy under [§ 215 of] the Investment Advisers Act of 1940 to void an investment advisers contract, but that the Act confers no other private causes of action, legal or equitable").

D. Petitioners' Approach Would Effectively Override The Limits Of The Federal Securities Laws, Which Provide Relief Only To Investors Who Purchased Or Sold Securities Based On Inaccurate Disclosures.

Petitioners complain that there were certain misstatements and omissions in the funds' SEC disclosures, suggesting that these should be actionable under § 36(b). (*See* Pet. Br. at 11-12.) As its plain terms make abundantly clear, however, § 36(b) is not a disclosure provision. Instead, § 34(b)

of the Act specifically prohibits misleading or omissive disclosure. *See* 15 U.S.C. § 80a-33(b) (prohibiting misleading statements in fund registration statements and other disclosure documents). Section § 34(b) is enforceable exclusively by the SEC. *See* 15 U.S.C. § 80a-41 (providing for SEC enforcement of the Act); *Bellikoff v. Eaton Vance Corp.*, 481 F.3d 110, 117 (2d Cir. 2007) ("the text and the structure of the ICA reveal no ambiguity about Congress's intention to preclude private rights of action to enforce §§ 34(b), 36(a), and 48(a)"). To the extent that rights of action to remedy disclosure violations are available to private litigants, those rights are set out in other provisions of the federal securities laws (equally applicable to mutual funds), which were carefully crafted by Congress to provide claims for new purchasers or sellers of securities, not for investors like petitioners who are pre-existing holders.

Section 11(a) of the 1933 Act gives a private right of action against various potential defendants with respect to a "registration statement . . . contain[ing] an untrue statement of material fact or omitt[ing] to state material fact required to be stated therein" only to a "person acquiring such security." 15 U.S.C. § 77k(a). Similarly, § 12(a)(2) creates an express right of action for "a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading" only for "the person purchasing such security." 15 U.S.C. § 77l(a)(2). In

addition, § 10(b) of the 1934 Act prohibits fraudulent statements or omissions "in connection with the purchase or sale[] of any security." 15 U.S.C. § 78j(b).

As this Court has recognized, Congress determined to limit these protections to those who "actually purchased or actually sold" securities pursuant to allegedly false disclosures -- not to pre-existing holders. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 736 (1975) (private rights of action under "the 1933 and 1934 Acts are by their terms expressly limited to purchasers or sellers of securities"); *Holmes v. Sec. Investor Prot. Corp.*, 503 U.S. 258, 277 (1992) ("[I]n *Blue Chip Stamps* . . . we confirmed the federal courts' 'longstanding acceptance' of the rule that a plaintiff must have actually purchased or sold the securities at issue in order to bring a Rule 10b-5 private damages action.") (O'Connor, J., concurring). Indeed, *Blue Chip Stamps* explicitly rejected extending claims under the 1933 and 1934 Acts to "actual shareholders in the issuer who allege that they decided not to sell their shares because of any unduly rosy representation or a failure to disclose unfavorable material" in a prospectus. 421 U.S. at 737-38. "When Congress wished to provide a remedy to those who neither purchase nor sell securities," the Court observed, "it had little trouble doing so *expressly*." *Id.* at 734 (emphasis added).

Accordingly, if a disclosure regarding mutual fund fees contains a material misstatement or omission, an investor who purchases or sells mutual fund shares in reliance on that misstatement has a remedy under the 1933 Act and/or the 1934 Act

against certain defendants, provided he or she also alleges and proves the other necessary elements of those claims.[4] However, no remedy is available under those provisions to a mutual fund investor who did not engage in a purchase or sale transaction based on alleged misrepresentations but simply continued to hold. To permit pre-existing holders of mutual fund shares to sue for misleading disclosures under § 36(b), as petitioners suggest, would allow them to evade the rule that only purchasers and sellers are entitled to bring disclosure claims. Nothing in the Investment Company Act or any of the other federal securities laws supports such a result.

II. PETITIONERS' APPROACH IS IMPRACTICAL AND UNDERMINES CONGRESS' INTENT AS TO THE PROPER SCOPE AND PURPOSE OF § 36(b).

A. The Practical Reality Is That Excessive Fee Litigation Is Lawyer-Driven.

At the time it enacted § 36(b), Congress was wary that the private cause of action it was creating could be used as a tool to harass and might lead to the filing of strike suits. *See* H.R. Rep. No. 91-1382, at 8

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[4] For limits on which potential defendants may be sued under § 10(b) of the 1934 Act, *see Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 177-178 (1994); *Stoneridge*, 128 S. Ct. at 773-774.

(§ 36(b) not meant to allow "the harassment of investment advisers by ill-founded and nuisance law suits, the so-called strike suit"). To mitigate against that risk, Congress reversed the burden of proof normally applicable in fiduciary cases, and placed the onus on plaintiffs to prove that a breach had occurred. *See* 15 U.S.C. § 80a-35(b)(1) (the "plaintiff shall have the burden of proving a breach of fiduciary duty"); *Green v. Fund Asset Mgmt., L.P.*, 286 F.3d 682, 685 (3d Cir. 2002) ("At common law it was incumbent on the fiduciary to justify his transaction with his cestui. Under this statute . . . the burden is reversed") (quoting *Gartenberg v. Merrill Lynch Asset Mgmt, Inc.*, 528 F. Supp. 1038, 1044 n.6 (S.D.N.Y.), *aff'd* 694 F.2d 923 (2d Cir. 1982)). Unfortunately, Congress' concern that § 36(b) would generate "strike suits by unscrupulous lawyers more interested in fees than the shareholders," 116 Cong. Rec. 33,279, 33,283 (1970) (Remarks of Rep. Stuckey), has proven all too well-founded.

Since § 36(b) was enacted in 1970, competition in the mutual fund industry has increased tremendously, fees have trended downward, and investors have benefited from an expanded array of mutual fund options. In the early 1960s, before the Act was amended to add the present § 36(b), fewer than 200 funds existed, with $23 billion under management. Wharton Sch. Of Fin. & Commerce, *A Study of Mutual Funds*, H.R. Rep. No. 87-2274, at 4 (1962). By 1966, that number had increased to only 379 funds, managing a total of just over $38 billion in assets. *See* John C. Coates IV and R. Glenn Hubbard,

Competition in the Mutual Fund Industry: Evidence and Implications for Policy, 33 J. Corp. L. 151, 157 (2007) (hereinafter "Coates & Hubbard"). In the nearly 40 years since § 36(b) was enacted, the mutual fund market has become much larger and more competitive. By 2008, the number of mutual funds in the United States had proliferated to nearly 9,000, with almost $10 trillion under management. *See* Investment Company Institute ("ICI"), *2009 Investment Company Factbook*, at 9, 15 (2009).[5] As competition has expanded, fees and expenses have gone down. Between 1980 and 2008, the asset-weighted average of total fees and expenses (which includes management fees, as well as sales loads, advertising and promotional charges, and other fees and expenses) fell among bond and stock funds by more than 57 and 63 percent, respectively. ICI, *Trends in the Fees and Expenses of Mutual Funds, 2008*, at 2 (2009).[6] *See also* Eleanor Laise, *As Returns Sag, Fund Investors Focus on Fees*, The Wall Street Journal, June 25, 2008, at D1 (mutual fund expense ratios fell "substantially" between 2003 and 2006).

At the same time, increased transparency regarding mutual fund management fees has become the norm. All mutual funds are required to disclose the amount of fees charged, the method by which fees are calculated, and the information fund directors considered in arriving at the fee. *See* SEC Form N-1A, Item 3 (requiring disclosure of the percentage of

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5 *Available at* http://www.ici.org/pdf/ 2009_factbook.pdf.

6 *Available at* http://www.ici.org/pdf/fm-v18n3.pdf.

management fees that are deducted from fund assets); Item 14 (requiring disclosure of the "method of calculating the advisory fee payable by the Fund"); 17 C.F.R. § 240.14a-101 (requiring disclosure of information upon which the board relied in determining the adviser's fee, including any comparison to the fees, services, and performance of other fund advisers, and the fees and services the adviser provides to other clients); SEC, Division of Investment Management, *Report on Mutual Fund Fees and Expenses* (Dec. 2000)[7] ("All funds are required to disclose their fees and expenses in a uniform manner so that an investor contemplating a fund investment today has access to comparable information about competing funds. This information helps investors make better investment decisions."). Indeed, the SEC recently issued new rules requiring that information regarding management fees be more prominently located in disclosure documents. Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Release No. 33-8998, 74 Fed. Reg. 4546, 4552-53 (Jan. 26, 2009). As the SEC explained, it adopted these new rules because it believes that "placement of the fee table in a more prominent location will encourage investors to give greater attention to costs." *Id.* at 4553.

Despite all of that, there has been an explosion in the number of cases brought against mutual fund

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[7] *Available at* http://www.sec.gov/news/studies/feestudy.htm

advisers. In the past several years, over 500 private class actions and derivative suits against mutual fund investment advisers have been commenced, with more suits being filed each day. James N. Benedict, Mary K. Dulka and Kimberly Wolf Price, *A Perfect Storm: Analyzing the Recent Explosion of Mutual Fund Litigation*, 1 Sec. Litig. Rep. 20, 20 (2004). Many of those lawsuits asserted claims under § 36(b) and were aimed at the advisers of the country's major mutual fund complexes. James N. Benedict et al., *Recent Developments In Litigation Involving Mutual Funds And Investment Advisers*, 2009 Prac. Law. Inst. Order No. 18,789, 1732 PLI/Corp. 943, 950.

The tsunami of excessive fee claims has been fueled by plaintiffs' lawyers, who have charged that the mutual fund "industry" at large is guilty of bilking innocent investors by charging exorbitant fees. For example, the website for co-lead plaintiffs' counsel in this case states:

> "Unfortunately, however, the over 53 million American households that have chosen to entrust their hard-earned dollars to mutual fund advisors and distributors are being taken advantage of in the form of excessive and unlawful fees and other abuses, which ultimately deplete the return on investment they seek . . . . For decades, the mutual fund industry has violated its duties to investors and the mutual funds they own by charging exorbitant fees . . . Richardson, Patrick, Westbrook & Brickman has sought to hold the

> mutual fund industry accountable for reaping excessive fees and profits at the expense of fund investors."[8]

Unsurprisingly, therefore, § 36(b) claims are not typically limited to particular individual funds. Instead, excessive fee litigation usually involves claims against advisers of entire fund complexes (*i.e.*, a family of different funds established by the same sponsor and managed by the same adviser), regardless of the size of the individual funds within the complex, their different investment styles, their performance, or their fee structure. Accordingly, excessive fee cases have even been filed on behalf of plaintiffs who do not own any shares in many of the funds that are the subject of their claims. *See, e.g., In re Salomon Smith Barney Mut. Fund Fees Litig.*, 441 F. Supp. 2d 579, 607 (S.D.N.Y. 2006) (suit brought against 88 funds in same complex despite fact that plaintiffs did not hold shares in 68 of those funds); *Forsythe v. Sun Life Fin., Inc.*, 417 F. Supp. 2d 100, 117 (D. Mass. 2006) (suit brought against family of 62 funds, although plaintiffs owned shares in only two of them); *In re Scudder Mut. Funds Fee Litig.*, No. 04-1921, 2007 WL 2325862, at *10 (S.D.N.Y. Aug. 14, 2007) (suit brought against more than 50 funds in same family; plaintiffs owned shares in three).

The targeting of mutual fund complexes has resulted in excessive fee cases being brought against advisers who charge fees that are actually *lower* than

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8 *Available at* http://www.rpwb.com/mutual_funds/.

the median fees charged by competitors across the mutual fund industry. The evidence shows that funds with higher than average fees are typically smaller funds. Ajay Khorana and Henri Servaes, *Conflicts of Interest and Competition in the Mutual Fund Industry*, at 3, 20 (2004).[9] Conversely, the median fees charged by the largest adviser firms are substantially lower than the overall median across all mutual fund categories. Denise A. Martin et al., NERA Econ. Consulting, *Trends on Mutual Fund Advisory Fees*, at 18 (2006).[10] Yet, the advisers of some of the nation's largest mutual fund families are often sued as § 36(b) defendants. In fact, based on the reported cases, advisers to more than half of the 50 largest mutual fund families in the United States (ranked by assets under management as of the third quarter of 2008)[11] have been sued under § 36(b).[12]

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[9] *Available at* http://papers.ssrn.comsd3/papers.cfm?abstract_id=240596.

[10] *Available at* http://www.nera.com/publication.asp?p_ID=2872.

[11] The list of fund families ranked by assets under management as of the third quarter of 2008 is available at http://genxfinance.com/2008/12/23/list-of-50-largest-mutual-fund-companies-ranked-by-assets-for-2008/.

[12] *See, e.g., Migdal*, 248 F.3d at 325 (T. Rowe Price Funds); *Verkouteren v. Blackrock Fin. Mgmt., Inc.*, No. 99-9005, 2000 WL 298255, at *1 (2d Cir. Mar. 21, 2000) (BlackRock Funds); *Alexander v. Allianz Dresdner Asset Mgmt. of Am. Holding, Inc.*, 509 F. Supp. 2d 190, 193 (D. Conn. 2007) (PIMCO funds); *In re Franklin Mut. Funds Fee Litig.*, 478 F. Supp. 2d 677, 679-80 (D.N.J. 2007) (Franklin Templeton Funds)*; In re Oppenheimer*

The litigation strategy pursued by the plaintiffs' bar has also resulted in excessive fee claims being brought against advisers of funds that outperformed the market while charging average or below-average fees. The present case is a prime example. The fees charged by Harris Associates were "in line" with those charged by "similar funds managed by other companies," as the trial court found. *Jones v. Harris Assocs. L.P.*, No. 04-8305, 2007 WL 627640, at *8 (N.D. Ill. Feb. 27, 2007). At the same time, Harris Associates delivered real "value" to investors for that money. *Jones v. Harris Assocs. L.P.*, 527 F.3d 627, 631 (7th Cir. 2008). All three of the funds at issue in this litigation significantly outperformed their peers. For example, during the three-year period ended March 31, 2004, the Oakmark Global Fund was ranked first in net returns out of 254 comparable funds as defined by Lipper. (J.A. at 138, 147.) The Oakmark Equity and Income Fund had the highest average annual net return of its 445 peers for the five-year period ending March 31, 2004. (J.A. at 146.) And, the Oakmark Fund ranked in the top four percent of funds in terms

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Funds Fees Litig., 426 F. Supp. 2d 157, 158 (S.D.N.Y. 2006) (Oppenheimer Funds); *In re Dreyfus Mut. Funds Fee Litig.*, 428 F. Supp. 2d 357, 357 (W.D. Pa. 2006) (Dreyfus Funds); *In re Morgan Stanley & Van Kampen Mut. Fund Sec. Litig.*, No. 03-8208, 2006 WL 1008138, at *5 (S.D.N.Y. Apr. 18, 2006) (Van Kampen and Morgan Stanley Funds); *In re Am. Mut. Funds Fee Litig.*, No. 04-5593, 2005 WL 3989803, at *4 (C.D. Cal. Dec. 16, 2005) (American Funds); *In re Davis Selected Mut. Funds Litig.*, No. 04-4186, 2005 WL 2509732, at *2 (S.D.N.Y. Oct. 11, 2005) (Davis Funds).

of net returns for the three-year period ending March 31, 2004. (J.A. at 147.). As a result of this performance, the Oakmark Fund and the Oakmark Equity and Income Fund made *Barron's* and *Money* magazine's lists of the world's top 100 mutual funds in August 2003. (J.A. 148.) The Oakmark Global Fund and the Oakmark Equity and Income Fund were also included in Lipper's 2004 list of 35 funds that "provided consistently superior returns in their respective groups." (*Id.*) In addition, the individual managers of the Oakmark Global Fund and the Oakmark Equity and Income Fund were named as the top managers in their respective investment categories by *Barron's* in 2004. (J.A. 149.)

There can be little doubt, therefore, that § 36(b) is currently being used by plaintiffs' lawyers in a way Congress never envisioned and purposefully sought to avoid. Indeed, this litigation is one of multiple lawsuits commenced by the same plaintiffs' counsel against dozens of funds in separate complexes, with complaints that were virtual carbon copies of one another.[13] Petitioners' boundless approach to § 36(b) will surely exacerbate this problem, not prevent it.

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[13] *See, e.g., Hunt v. Invesco Funds Group*, No. 04-cv-2555 (S.D. Tex); *Baker v. Am. Century Inv. Mgmt.*, No. 04-cv-4039 (W.D. Mo.); *Gallus v. Am. Express Fin. Corp.*, No. 04-cv-4498 (D. Minn.); *Strigliabotti v. Franklin Res., Inc.*, No. 04-cv-883 (N.D. Cal.); *Dumond v. Mass. Fin. Servs. Co.*, No. 04-cv-11458 (D. Mass.); *Krueger v. Neuberger Berman Mgmt., Inc.*, No. 05-cv-1316 (S.D.N.Y.); *Williams v. Waddell & Reed Inv. Mgmt. Co.*, No 04-cv-2561 (D. Kan.).

B. That An Adviser Does Not Disclose That It Charges Different Fees To Different Clients For Different Services Provides No Basis To Infer A Violation Of § 36(b).

Petitioners posit that the fiduciary duty in § 36(b) requires "full and accurate disclosure of all material facts" in connection with the determination of management fees, regardless of whether the omission of such facts would have had any impact on the fees actually awarded. (Pet. Br. at 21.) In particular, they suggest that the rates an adviser charges to "different clients" are "highly probative" of whether a breach of fiduciary duty has occurred (*id.* at 30-31) and that therefore such rates (and the reasons for the differences) must always be disclosed (*id.* at 37). If petitioners were correct, however, it would be virtually impossible for defendants to secure dismissal of even the weakest of claims without having to go through the costly and burdensome discovery that the defense of securities claims notoriously entails.

For example, petitioners appear to recognize that the fact that an investment adviser charges different rates to different clients does not necessarily amount to a violation of § 36(b). (*See id.* at 30-31, 37.) And indeed, there are many significant differences between the services investment advisers provide to registered mutual funds and those they provide to different clients that justify different fee arrangements. *See* ICI, *Mutual Funds and*

Institutional Accounts: A Comparison, at 1 (2006)[14] (comparisons between fees charged to mutual funds and fees charged to institutional funds "can be highly misleading because of the dissimilarities between mutual funds and institutional accounts") (hereinafter "Comparison Study"); Coates & Hubbard, at 185 ("retail and institutional customers consume different services or differ in the underlying cost of generating services").

For example, while the services provided to institutional clients are principally limited to security selection, mutual funds are heavily regulated (by the ICA and other securities laws) and require significant compliance services that are not typically applicable to institutional clients. Comparison Study at 5-6; Coates & Hubbard at 162, 185. In addition, mutual fund shares are typically held by a large number of relatively small accounts, which makes recordkeeping, transfer agent, and related services more costly. Comparison Study at 3-5; Coates & Hubbard at 185, 192 n.158. Investment advisers also commonly provide mutual fund clients with shareholder-related services that institutional investors do not require. Comparison Study at 3-5; Coates & Hubbard at 162, 185. Advisers who manage mutual funds also face business and entrepreneurial risks that are absent when they provide services to institutional clients.

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[14] *Available at* http://www.anbid.com.br/institucional/documentos_download/Fundos/Estudos%20e%20Estat%C3%ADsticas%20Mundiais/ICI%20-%20Mutual%20Funds%20and%20Institutional%20Accounts.pdf

The start-up of a new mutual fund requires an investment of financial and human capital, and carries the risk that this investment will not be recouped. Comparison Study at 8.

Thus, the mere fact that an adviser charges different fees to different clients provides no basis to infer that an adviser received excessive compensation from a mutual fund.

Congress recognized that a fund's board of directors is in the best position to determine what information it needs and what fees are proper. 15 U.S.C. § 80a-15(c) (directors to request "such information as may reasonably be necessary" to determine fees); S. Rep. No. 91-184 at 6 (§ 36(b) "is not intended to authorize a court to substitute its business judgment for that of the mutual fund's board of directors in the area of management fees"); 15 U.S.C. § 80a-35(b)(2) (courts to give appropriate consideration to board's approval of management fees). The practical effect of petitioner's approach, however, is that a § 36(b) plaintiff would be able to evade dismissal merely by alleging the commonplace fact that different fees were charged to different clients. Such an allegation would thus be the key that always opens the door to massive discovery concerning whether those fee differences were warranted or not.

A § 36(b) plaintiff should not be entitled to subject defendants to massive discovery and burden our already overworked courts merely by making rudimentary and conclusory allegations of breach,

without ever having to allege facts demonstrating causation, injury, or the other elements of a claim. *See* 15 U.S.C. § 80a-35(b)(3) ("[a]ny award of damages against such recipient [of excessive advisory fees] shall be limited to the actual damages resulting from the breach of fiduciary duty"); *see also Dura Pharms., Inc. v. Boudro*, 544 U.S. 336, 346 (2005) ("plaintiffs' need to *prove* proximate causation and economic loss leads us also to conclude that the plaintiffs' complaint here failed adequately to *allege* these requirements") (emphasis in original); *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949-50 (2009) (no discovery should be permitted in the absence of factual allegations sufficient to demonstrate a plausible right to relief); *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570 (2007) (same).

C. Petitioners' Approach Would Create Coercive Pressure To Settle Even Meritless Suits.

As Congress recognized in considering reforms to the 1934 Act, discovery accounts for 80 percent of the costs of defending securities law claims. H.R. Rep. No. 104-369, at 37 (1995) (Conf. Rep.). Discovery also requires "key employees" to dedicate substantial time to depositions and responding to discovery requests. *Id.* Just as in the § 10(b) context, the burdens of discovery in § 36(b) cases fall disproportionately on defendants because they "possess[] the bulk of the relevant information." H.R. Rep. No. 104-50, at 16 (1995). Plaintiffs, by contrast, have few documents that could be subject to

burdensome discovery requests and therefore have no incentive to propound reasonable discovery demands.

The enormous costs of discovery create tremendous pressure on defendants to settle, as both Congress and this Court have recognized. *See, e.g.,* H.R. Rep. No. 104-369, at 31 (plaintiffs can often use discovery to "impose costs so burdensome that it is often economical for the victimized party to settle"); H.R. Rep. No. 105-803, at 13 (1998) (Conf. Rep.) (companies often settle strike suits "simply to avoid the potentially bankrupting expense of litigating"); *Stoneridge*, 128 S. Ct. at 772 (noting that "extensive discovery and the potential for uncertainty and disruption in a lawsuit allow plaintiffs with weak claims to extort settlements from innocent companies"); *Dura*, 544 U.S. at 347 (refusing to "permit a plaintiff with a largely groundless claim to simply take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value rather than a reasonably founded hope that the discovery process will reveal relevant evidence") (internal quotation marks omitted); *see also Amron v. Morgan Stanley Inv. Advisors Inc.*, 464 F.3d 338, 346 (2d Cir. 2006) (quoting *Dura* in affirming dismissal of § 36(b) complaint).

Petitioners' broad standard for what constitutes a breach of fiduciary duty thus would arm § 36(b) plaintiffs with the ability to extract settlements regardless of the underlying merits of their claims. That is not a result Congress intended in enacting § 36(b), nor one this Court should allow.

D. Petitioners' Approach Would Unfairly Burden Advisers, Funds And Fund Shareholders Alike.

Petitioners' broad-based approach to § 36(b) would also cause detrimental "ripple effects," *Cent. Bank*, 511 U.S. at 189, throughout the industry, unfairly burdening advisers, funds and shareholders alike.

First, if advisers are faced with the prospect of having to defend excessive fee suits even when their fees are not excessive compared to industry averages, they may simply opt out of offering mutual funds altogether, diminishing the number of mutual funds available for investment and dampening competition. *See* John C. Coates IV, *Reforming the Taxation and Regulation of Mutual Funds: A Comparative Legal and Economic Analysis*, at 30 (2009)[15] (noting that other types of collective investment vehicles that are not subject to the ICA have been growing faster than funds subject to the ICA, and predicting that within ten to 20 years there will be more assets in the former category than in the latter); Herbert Lash, *Over 250 Mutual Funds Liquidate, Cite Rule Costs*, Reuters, Sept. 14, 2005 (over 250 mutual funds liquidated in 2008, primarily due to costs of complying with new regulations). That will redound to the detriment of all mutual fund investors, who will be left with fewer investment choices.

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15 *Available at* http://www.capmktsreg.org/research.

Second, although § 36(b) claims are directed against advisers, they also pose an economic cost to the funds themselves, on whose behalf such claims are ostensibly brought. For example, discovery in a § 36(b) case will often include the depositions of a fund's directors or trustees and the production of a significant volume of documents by the fund. *See, e.g.*, *Williams v. Waddell & Reed Mgmt. Co.*, No. 04-2561 (D. Kan. Sept. 25, 2006) (Stipulation of Dismissal) (noting that plaintiffs have "sought and obtained substantial discovery from W&R and certain non-parties," including deposing "more than twenty senior representatives of W&R and eight independent directors on the Funds' Boards of Directors"). The costs and burdens associated with this discovery are borne by the fund, not the adviser, and do not constitute recoverable damages even if the case succeeds.

Third, it is in fact the shareholders who usually end up footing the bill for the costs of defending abusive § 36(b) claims. Under the ICA, a management agreement may provide for advancement rights, requiring funds to cover an adviser's legal costs upon an undertaking to repay and provided certain other conditions are met. 15 U.S.C. § 80a-17(i); Indemnification by Investment Companies, Investment Company Act of 1940 Release No. 11,330, 45 Fed. Reg. 62,423 (Sept. 4, 1980) (Sept. 4, 1980) (funds may advance attorneys' fees to adviser under certain conditions). Many management contracts contain such advancement provisions. *See, e.g.,* Brazilian Equity Fund, Inc., Notice of

Application, Investment Company Act Release No. 26,781, 70 Fed. Reg. 12,909, 12,911 n.3 (Mar. 9, 2005) (management agreement entitles the adviser to advancement of "reasonable expenses"). In many cases, therefore, the fund must pay for the costs of the adviser's defense out of fund assets. Because fund assets are nothing more than the combined investments of its shareholders, the real losers are shareholders themselves, out of whose pockets such costs ultimately come.

CONCLUSION

For the foregoing reasons, the decision of the court of appeals should be affirmed.

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