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 RESPONDENT

JEFFREY A. LAMKEN
BAKER BOTTS L.L.P.
1299 Pennsylvania Ave., NW
Washington, D.C. 20004-2400
(202) 639-7700

AARON M. STREETT
BAKER BOTTS L.L.P.
910 Louisiana Street
Houston, TX 77002
(713) 229-1234

JOHN D. DONOVAN, JR.
*Counsel of Record*
ROBERT A. SKINNER
BENJAMIN S. HALASZ
BRIAN R. BLAIS
ROPES & GRAY LLP
One International Place
Boston, MA 02110-2624
(617) 951-7000

*Counsel for Respondent*

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D.C. 20002

## QUESTION PRESENTED

Section 36(b) of the Investment Company Act of 1940, 15 U.S.C. § 80a-35(b), states that investment advisers have a "fiduciary duty with respect to the receipt of compensation" from mutual funds, and creates a private cause of action for shareholders to enforce that obligation. For nearly 30 years, the mutual fund industry and the SEC have agreed upon the understanding of that text set forth in the Second Circuit's decision in *Gartenberg* v. *Merrill Lynch Asset Management, Inc.*, 694 F.2d 923 (2d Cir. 1982): To breach its "fiduciary duty with respect to the receipt of compensation," the "adviser-manager must charge a fee that is *so disproportionately large* that it bears no reasonable relationship to the services rendered and *could not have been the product of arm's-length bargaining*." *Id.* at 928 (emphasis added). In this case, the district court granted summary judgment on undisputed facts that expenses were similar to (or even below) competitors' charges despite best-in-class performance, and were the result of a robust and fully informed negotiation between the adviser and the funds' disinterested trustees. The Seventh Circuit affirmed.

The question presented is whether the "fiduciary duty with respect to the receipt of compensation" imposed by §36(b) requires a shareholder to prove that a mutual fund adviser's fee was so disproportionately large that it could not have been the product of arm's-length bargaining.

## CORPORATE DISCLOSURE STATEMENT

Pursuant to Supreme Court Rule 29.6, Respondent Harris Associates L.P. ("Harris") states that it is a Delaware limited partnership managed by its general partner, Harris Associates, Inc., which owns 0.33% of the limited partnership interests. Harris Associates, Inc. is a wholly-owned indirect subsidiary of Natixis Global Asset Management, L.P. ("Natixis U.S."). Natixis U.S. owns 99.67% of Harris's limited partnership interests and, through its wholly-owned subsidiary, Natixis Global Asset Management Holdings, LLC, all of the outstanding shares of Harris Associates, Inc. No publicly held corporation owns 10% or more of Harris's stock.

Natixis U.S. is part of Natixis Global Asset Management, an international asset management group based in Paris, France, that is ultimately owned principally, directly or indirectly, by three affiliated French financial services firms: Natixis, an investment banking and financial services firm; the Caisse Nationale des Caisses d'Epargne, a financial institution owned by French regional savings banks known as the Caisses d'Epargne; and the Banque Federale des Banques Populaires, a financial institution owned by regional cooperative banks known as the Banques Populaires. Natixis is a public company whose shares trade on the Euronext Paris exchange.

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## BRIEF FOR RESPONDENT

## STATEMENT

In 1970, Congress amended the Investment Company Act of 1940 ("ICA"), 15 U.S.C. § 80a-1 *et seq.*, to reinforce the statute's protections for investors with respect to the fees that mutual funds pay to their investment advisers. See Investment Company Amendments Act of 1970 (the "1970 Amendments"), Pub. L. No. 91-547, 84 Stat. 1413. Recognizing the "cornerstone" role of independent mutual fund boards, the 1970 Amendments "strengthened" the ICA's requirement of director independence, *Burks* v. *Lasker*, 441 U.S. 471, 482 (1979); required investment advisers to provide mutual fund boards with exhaustive information material to fee negotiations; and vested in the independent directors the exclusive authority to approve a fee contract. 15 U.S.C. §§ 80a-2(a)(19), 80a-10(a), 80a-15(c).

Congress coupled those enhancements with a new enforcement mechanism. Congress added § 36(b) to the ICA to provide that investment advisers have a "fiduciary duty with respect to the receipt of compensation" and created a private cause of action for breach of that duty. 15 U.S.C. § 80a-35(b). In selecting the "fiduciary duty" formulation, Congress navigated between earlier proposals requiring that fees be "reasonable," and state-law rulings that limited fee review to concepts of "waste." Congress rejected a "reasonable" fee standard because it would authorize a court to "substitute its business judgment" for the actions of the board of directors. See S. Rep. No. 184, 91st Cong., 1st Sess. 6 (1969). State law "waste" standards, on the other hand, deferred to board decisions with little regard for the quality of board deliberations. *Id.* at 5. Congress chose the "fiduciary duty" standard as a compromise between the two extremes, and ordered that courts reviewing claims for breach of the obligation "shall" give "approval by the [mutual fund's] board of directors * * * such consideration as is deemed appropriate under all the circumstances." 15 U.S.C. § 80a-35(b)(2).

This case concerns the standard for determining whether a "breach of fiduciary duty with respect to the receipt of compensation" has occurred.

## I. STATUTORY AND INDUSTRY BACKGROUND

### A. Statutory Background

A mutual fund is an investment company that pools money from multiple investors for investment in stocks, bonds, or other securities. Mutual funds offer an attractive and popular investment vehicle for many individuals. They allow disparate and dispersed investors to obtain the benefits of professional management of their investment dollars and diversification across multiple investments and asset classes. There are mutual funds available for every asset class, investment style, and industrial and geographical sector. Mutual funds afford investors substantial liquidity, allowing them to redeem shares for reinvestment elsewhere with ease.

1. The management of mutual funds is typically externalized. Most mutual funds "are formed, sold, and managed" by a "separately owned and operated" investment adviser that "select[s] the funds' investments and operates their business." *Burks*, 441 U.S. at 481 (quoting S. Rep. No. 184, *supra*, at 5); see *Daily Income Fund* v. *Fox*, 464 U.S. 523, 536 (1984). Contractually delegating management to an external adviser, however, poses the risk of conflicts between the fund and its manager. *Burks*, 441 U.S. at 481. Accordingly, the ICA requires mutual funds to be independent from, and disinterested with respect to, their investment advisers in multiple ways. *Id.* at 482; 15 U.S.C. §§ 80a-10(a) to 10(b), 80a-15(a) to 15(c). That requirement is the "cornerstone of the ICA's effort to control conflicts of interest within mutual funds." *Burks*, 441 U.S. at 482. At least 40 percent of a mutual fund's directors or trustees must be "disinterested" with respect to the investment adviser. 15 U.S.C. § 80a-10(a). The ICA "assigns a host of special responsibilities" to those "statutorily disinterested" board members. *Burks*, 441 U.S. at 482-83. Critically, they must "review and approve the contracts of the investment adviser" annually. *Id.* at 483. And the fees paid to the in-

vestment adviser may be established only by a majority of disinterested trustees. 15 U.S.C. § 80a-15(c).

Section 15(c) of the ICA requires investment advisers to furnish, and independent directors to examine, all information "reasonably * * * necessary to evaluate the terms" of any investment advisory contract. 15 U.S.C. § 80a-15(c). That includes extensive disclosures relating to the adviser's fees, costs, and profits. SEC rules require funds to disclose to shareholders the weight boards attribute to (a) the costs of services the investment adviser provides, (b) the profits the investment adviser realizes, (c) the extent of economies of scale as the fund grows, and (d) how such economies benefit investors. See 69 Fed. Reg. 39,798, 39,808 (June 30, 2004). Independent board members are thus in a position to act as "independent watchdogs." *Burks*, 441 U.S. at 484 (quoting *Tannenbaum* v. *Zeller*, 552 F.2d 402, 406 (2d Cir. 1977)).

2. Motivated by the "substantial growth of the investment company industry since 1940," see H.R. Rep. No. 2337, 89th Cong., 2d Sess. vii (1966), Congress amended the ICA in 1970 to "strengthen further the independence" of fund boards, *Burks*, 441 U.S. at 483. The 1970 Amendments imposed "stricter requirement[s]" limiting director "interests," *id.* at 482-83; see 15 U.S.C. § 80a-2(a)(19), and added provisions "designed to assist directors in discharging their responsibilities," S. Rep. No. 184, *supra*, at 6, including the requirement that advisers disclose to independent directors all information "reasonably * * * necessary to evaluate the terms" of any investment advisory contract, 15 U.S.C. § 80a-15(c).

At the same time, Congress established a new mechanism to authorize federal legal challenges to management fees. Although Congress specifically declined to find that advisory fees were generally excessive,[1] Congress added §36(b) to the ICA, which provides that investment advisers have "a fiduciary duty with respect to the receipt of compensation" from a mutual fund. 15 U.S.C. §80a-35(b). The measure created a private cause of action for shareholders to assert on behalf of a fund "for breach of fiduciary duty in respect of such compensation or payments" to the investment adviser. *Ibid.*

3. Congress formulated the "fiduciary duty with respect to the receipt of compensation" as a compromise between state-law "waste" standards and a previously proposed standard of "reasonableness." The "corporate waste" standard that some courts had applied to claims of excessive adviser compensation had been heavily criticized. S. Rep. No. 184, *supra*, at 5; see, *e.g.*, *Saxe* v. *Brady*, 40 Del. Ch. 474, 486 (1962). Under that standard, board approval of fees was often dispositive, with little regard to the quality of the board's deliberations. Courts would upset a fee only if it was "unconscionable" or "shocking." *Daily Income Fund*, 464 U.S. at 534 n.10, 540 n.12. Congress deemed such "waste" standards "unduly restrictive." S. Rep. No. 184, *supra*, at 5.

Congress also rejected proposals that advisory fees be "reasonable." It "delet[ed]" the "requirement of 'reasonableness'" from versions of a bill the Senate passed in a prior session, and "substitute[d]" the fiduciary-duty standard as "a different method of testing management compensation." S. Rep. No. 184, *supra*, at 5. Congress noted that under the "fiduciary duty" standard, a court

[1] See S. Rep. No. 184, *supra*, at 5 (provisions "should not be taken as reflecting any finding by the committee that the present industry level of management fees or that the fee of any particular adviser is too high"); *id.* at 6 ("provision does not represent a finding by the committee as to the level of fees in the industry").

would not "substitute its business judgment for that of the mutual fund's board of directors in the area of management fees." See *ibid*.

Congress's path between the extremes also found expression in a provision giving courts discretion to determine how much weight to give to the board's approval of a fee. Under § 36(b)(2), courts "shall" accord board approval "such consideration * * * as is deemed appropriate under all the circumstances." 15 U.S.C. § 80a-35(b)(2). Congress proposed that courts ask "whether the deliberations of the directors were a matter of substance or a mere formality." H.R. Rep. No. 1382, 91st Cong., 2d Sess. 37 (1970). A "responsible determination regarding the management fee by the directors including a majority of disinterested directors is not to be ignored." S. Rep. No. 184, *supra*, at 6.

4. Congress's adoption of a "fiduciary duty" standard created a "unique right," *Daily Income Fund*, 464 U.S. at 524, that was drawn from familiar principles. But Congress modified those principles to adapt them to the context of mutual funds. A fiduciary ordinarily bears the burden to justify its transactions under applicable substantive rules. See *Pepper* v. *Litton*, 308 U.S. 295, 306 (1939) (citing *Geddes* v. *Anaconda Copper Mining Co.*, 254 U.S. 590, 599 (1921)). In § 36(b), Congress reversed that burden, imposing "the burden of proving a breach of fiduciary duty" on the plaintiff. 15 U.S.C. § 80a-35(b)(1). Congress also limited recovery under § 36(b) to "actual damages" arising from the breach, and excluded recovery "for any period prior to one year before the action was instituted." *Id.* § 80a-35(b)(3).

**B. Developments In The Mutual Fund Industry**

Since the 1970 Amendments were enacted, the mutual fund industry has experienced exponential growth. Assets under management increased from $38.2 billion, H.R. Rep. No. 2337, *supra*, at vii, to over $9.6 trillion in 2008, ICI Fact Book 20 (May 2009), http://www.icifactbook.org/pdf/2009_factbook.pdf. The number of mutual fund investors increased more than 20-fold from 3.5 million in 1965 to 92 million in 2008. *Id.* at 73. Some 700 financial services companies compete for investors' dollars by sponsoring fund "families" that offer an array of funds across multiple asset classes and investment objectives. *Id.* at 13. Those companies afford choices among almost 8,900 open-end mutual funds, approximately 650 closed-end funds, and over 700 Exchange Traded Funds. *Id.* at 15. Bank deregulation and the migration from defined benefit to defined contribution retirement plans have helped fuel this growth. *Id.* at 77. Low barriers to industry entry—and the absence of barriers to investment exit—have also driven this expansion. John C. Coates, IV & R. Glenn Hubbard, *Competition in the Mutual Fund Industry: Evidence and Implications for Policy*, 33 J. Corp. L. 151, 167-70 (2007).

In that dynamic environment, competition among fund complexes is fierce. While advisers rarely compete for the business of funds formed by competitors, sponsors of fund complexes compete aggressively for investors' dollars on the basis of factors such as fees, performance, and service. Coates & Hubbard, *supra*, at 153, 196. As a result, the average expenses for stock funds declined from 2.32% of assets in 1980 to 0.99% in 2008. ICI Fact Book, *supra*, at 60-61; see also Coates & Hubbard, *supra*, at 173-77.

SEC regulations compel exhaustive disclosure about fund performance, fees, and comparative information. See *Disclosure Regarding Approval of Investment Advisory Contracts by Directors of Investment Companies*, 69 Fed. Reg. 39,798, 39,807-09 (2004). Self-regulatory organizations and private enterprises have erected an enormous informational edifice to complement the mandatory disclosure regime, including services such as Morningstar.com. See, *e.g.*, *Calculating Mutual Fund Fees and Expenses*, http://www.sec.gov/investor/tools/mfcc/mfcc-int.htm; FINRA Fund Analyzer, http://apps.finra.org/fundanalyzer/1/fa.aspx. Investors affirmatively respond to these resources. Between 1999 and 2008, funds with below-mean expense ratios obtained dramatically increased investment inflows and funds with above-mean expenses suffered net outflows. ICI Fact Book, *supra*, at 63. As the Seventh Circuit summarized, "investors can and do 'fire' advisers cheaply and easily by moving their money elsewhere" when fees "are excessive in relation to the results." Pet. App. 11a-12a.

**II. PROCEEDINGS IN THIS CASE**

Respondent Harris Associates L.P. ("Harris") is an investment adviser. Petitioners own shares in three funds that Harris manages in the Oakmark "family" of mutual funds: the Oakmark Fund, the Oakmark Equity and Income Fund, and the Oakmark Global Fund (the "Funds"). J.A. 138-39. On August 17, 2004, petitioners commenced this action on behalf of those Funds, alleging that during the one-year period before the Complaint was filed, Harris breached its fiduciary duty with respect to the receipt of compensation under § 36(b) by charging "excessive" fees. J.A. 52; Pet. App. 29a. The same lawyers simultaneously filed nearly identical complaints against a dozen separate complexes.[2]

[2] See *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.); *Bauer* v. *Federated Equity Mgmt. Co.*, No. 04-cv-702 (W.D. Pa.); *Bennett* v.

### A. Performance, Fees, And Fee Negotiations

During the one-year period preceding the Complaint, the Funds outperformed their respective market benchmarks and virtually every fund in their peer universe. For that best-in-class performance, petitioners paid aggregate fees and expenses similar to—or below—those paid by comparable funds.

1. *Harris's Performance Record*

Harris and the Funds' independent board renegotiated contracts every year. The Funds' independent trustees engaged industry consultant Lipper, Inc. to assist in their effort. J.A. 144-45.

*Global Fund.* For the three- and four-year periods ending on March 31, 2004, the Oakmark Global Fund had the single best net returns of the 200-plus comparable funds in its Lipper-defined "performance universe"; for each time period, it exceeded the benchmark index by over 20 percentage points. J.A. 147, 280. The average annual return for the three-year period ending on March 31, 2004 was 22.36% net of fees, better than *any* of the funds Lipper considered comparable. That annualized return was nearly 10 times its Lipper benchmark. *Ibid.* The Global Fund's average annual net return over the preceding four-year period was 20.24%—again the single best performance result of any comparable fund; by contrast, the Lipper benchmark had an average annual *loss*. *Ibid.*

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*Fidelity Mgmt. & Research Co.*, No. 04-cv-11651 (D. Mass.); *Strigliabotti* v. *Franklin Res., Inc.*, No. 04-cv-883 (N.D. Cal.); *Sins* v. *Janus Capital Mgmt. LLC*, No. 04-cv-1647 (D. Colo.); *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.); *Vaughn* v. *Putnam Inv. Mgmt.*, No. 04-10988 (D. Mass.); *Williams* v. *Waddell & Reed Inv. Mgmt. Co.*, No. 04-cv-2561 (D. Kan.).

*Equity and Income Fund.* For the three-year period ending on March 31, 2004, the Equity and Income Fund returned on average 12.49% net of fees, the third best performance of 445 peer funds and over three times its Lipper benchmark. J.A. 146, 272. For the five-year period ending on March 31, 2004, the Equity and Income Fund's average annual net return of 13.91% was the best in its peer universe, and far above the benchmark return of 3.11%. *Ibid.* The Equity and Income Fund's performance exceeded its Lipper benchmark by almost 9 percentage points in the three-year period and by over 10 percentage points in the five-year period. *Ibid.*

*Oakmark Fund.* For the three-year period ending on March 31, 2004, the Oakmark Fund generated an average annual return of 6.22% net of fees, about four times its Lipper benchmark. J.A. 147, 297. Lipper ranked the fund 12th out of the 307 funds Lipper considered comparable. *Ibid.* For the five-year period ending on March 31, 2004, the Oakmark Fund's average annual net return was 5.29%, more than four times the benchmark's 1.22%, and the fund ranked 18th out of 224 comparable funds. *Ibid.*

Harris's performance garnered widespread accolades. See J.A. 147-49. *Money* magazine awarded Oakmark funds "top marks" for having "especially laudable or innovative policies" in its survey of "fund companies [that] put investors first." *Id.* at 148. Morningstar selected the Oakmark Fund's portfolio manager as the industry's "Domestic Stock Manager of the Year" for 2001. *Ibid.* *SmartMoney* magazine named him one of the 11 top fund managers out of 11,000 under consideration. *Id.* at 149. *Barron's* similarly named the managers of Oakmark Equity and Income Fund and Oakmark Global Fund as the top managers in their respective categories. *Ibid.*

2. *The Fees*

Despite best-in-class performance, Fund shareholders paid management fees and expenses that were unremarkable. Management fees for the Funds were at or slightly above medians for comparable funds. See J.A. 271-86, 291-98. Aggregate expenses compared favorably to peers. The Global Fund's aggregate expenses were 0.168% below the median for its peer group. Total expenses for the Equity and Income Fund and the Oakmark Fund exceeded their respective peer medians by 0.025% and 0.174%. J.A. 145.

Harris supplied the trustees with materials on a wide variety of topics related to those fees. The materials described the multiple services Harris provides to the Funds; the Harris personnel providing those services; the investment performance of the Funds; and the profitability of the contracts to Harris. Harris gave the trustees detailed information about Harris's expenses; transactions between the Funds and Harris's affiliates (*e.g.*, its broker-dealer); "soft-dollar" and similar benefits to Harris; and compliance information about best execution of portfolio transactions, the allocation of transactions among broker-dealers, and compliance with the Funds' investment restrictions. J.A. 143-44, 152-81.

Harris also provided the Funds' trustees with extensive data about its activities as an investment adviser to a variety of non-mutual fund clients, including the accounts of institutional investors and high net-worth individuals, as well as its provision of "sub-advisory" services to various mutual funds for which other investment advisers acted as the primary adviser. J.A. 146. The Funds' trustees requested and Harris provided a description of the fees Harris charged to those non-mutual fund clients as well as a comparison of the more extensive services Harris provided to the Funds with those provided to other clients. J.A. 146, 152-81.

3. *The Fee Negotiations*

The negotiations culminating in each fee contract were robust. J.A. 141-45. They spanned several months and multiple meetings between Harris and the trustees. *Id.* at 141-43. Much of the trustees' information gathering and analysis was completed by the board's Management Contracts Committee, which made a recommendation to the full board for consideration. *Id.* at 143. The Management Contracts Committee met on multiple occasions over each contract negotiation cycle. *Ibid.* The trustees were advised throughout by independent, outside legal counsel. *Id.* at 143-44.

The trustees negotiated increasingly favorable terms. Mutual fund fee agreements often provide "breakpoints"—asset levels at which an asset-based fee declines. In the years preceding the filing of the Complaint, the Funds' trustees negotiated the initiation of additional breakpoints for the Funds. J.A. 140-41. Rather than "resisting" such breakpoints, as petitioners contend, Pet. Br. 11, the trustees negotiated two new breakpoints for the Oakmark Fund, four new breakpoints for the Equity and Income Fund, and two new breakpoints for the Global Fund during the 2003 and 2004 fee negotiation processes. J.A. 140-41.

**B. Proceedings In District Court**

Petitioners' Complaint alleged that Harris's fees were "disproportionate to the services rendered" and "not within the range of what would have been negotiated at arm's length in light of all the surrounding circumstances." J.A. 52. The pleading explicitly declared that the Second Circuit's decision in *Gartenberg* v. *Merrill Lynch Asset Management, Inc.*, 694 F.2d 923 (2d Cir.

1982) ("*Gartenberg*"), set forth the "test for determining whether compensation paid to Defendant violates § 36(b)." J.A. 36.

After extensive discovery, both parties moved for summary judgment. Harris relied upon the *Gartenberg* standard that petitioners' Complaint invoked: It argued that, on the undisputed record, the fees it charged were not so disproportionate that they could not have been the product of arm's-length bargaining. See Mem. of Law in Supp. of Def. Harris Associates L.P.'s Mot. for Summ. J. at 14-26. The petitioners' opposition abandoned *Gartenberg*, asserting they "do *not* agree that *Gartenberg* sets forth the appropriate test for determining whether a violation of § 36(b) has occurred." Mem. of Law in Supp. of Pls.' Opp. to Def. Harris Assocs. L.P.'s Mot. for Summ. J. at 6 n.4 (emphasis added).

The district court adopted *Gartenberg*'s "so disproportionate" standard as the "applicable framework for [its] analysis." Pet. App. 29a. The district court also adopted *Gartenberg*'s analytical rubric, looking to six non-exclusive factors that *Gartenberg* identified as relevant to the "so disproportionate" analysis. Those factors include: (1) the nature and quality of the services rendered; (2) the profitability of the funds to the adviser; (3) economies of scale; (4) comparative fee structures; (5) fallout benefits; and (6) the conscientiousness of the board. *Id*. at 28a (citing *Gartenberg*, 694 F.2d at 929-30).

After examination of "all facts pertinent to the amount of fees paid," the district court held that petitioners had not raised a triable issue of fact on "whether the fees charged to the Funds" during the relevant period were "so disproportionately large that they could not have been the result of arm's-length bargaining." Pet. App. 27a, 29a; see also *id.* at 28a.

The court emphasized that, because advisory fees are the product of negotiation, no single result could be expected: "[T]here is a range of acceptable results." Pet. App. 29a. But there was no "dispute that Harris's fees were comparable to those charged by other similar funds." *Id*. at 30a. Petitioners did not deny that the Funds "performed well"—indeed, extraordinarily well—"during the damages period." *Id.* at 30a, 32a. And there was no genuine dispute that the Funds' trustees "operat[ed] without any conflict" that would prevent "arm's-length negotiations" with Harris. *Id.* at 31a. The undisputed facts showed that the "shareholders' interests were represented at the negotiating table by a group of people who were capable of giving those interests primacy." *Ibid.*

The court rejected petitioners' contention that the breakpoints negotiated by the trustees did not adequately share economies of scale with shareholders. The court held that the trustees need not set breakpoints at the lowest possible level, but rather at levels that reflected good-faith, arm's-length negotiation. Pet. App. 31a. Petitioners produced no evidence suggesting that the negotiated results did not meet this standard. The breakpoints were "comparable to what shareholders in other mutual funds had accepted." *Id.* at 31a-32a.

The district court also rejected petitioners' argument that the fees Harris charged the Funds must be substantially similar to fees charged to institutional clients. Pet. App. 30a. The undisputed facts established that Harris provided "more limited" services to institutional clients than it provided to the Funds. *Id.* at 16a.[3] The court fur-

[3] Petitioners' assertion that the district court ruled that fee differentials for "indistinguishable" services "did not matter," Pet. Br. 13, mischaracterizes the ruling. The court specifically held that the ser-

ther held that, even if one assumed that institutional investors received identical services, the evidence did not show that the fees paid by the Funds exceeded the amount that could have resulted from arm's-length negotiations. The Funds' fees fell comfortably within the range of all fees Harris charged to all client types. *Id*. at 30a. That, the court explained, "prevent[s] a conclusion that the amount of fees indicates that self-dealing was afoot." *Ibid.*

The district court finally reviewed and rejected petitioners' various claims of misconduct, including claims that social and business contacts between members of the board made them "interested," violated other provisions of the ICA, or otherwise tainted the fee negotiations. Pet. App. 24a-26a. First, the court held that petitioners could not shoehorn ostensible violations of other sections of the ICA—sections that are not privately enforceable—into a § 36(b) claim. *Id.* at 24a-25a. Moreover, the court held that petitioners' catalogue of supposed intra-board conflicts had no impact on the analysis of a breach of duty "with respect to the receipt of compensation." See *id.* at 25a-26a. "[O]nly an actual conflict that resulted in an identified effect on shareholders' interests" will factor into the § 36(b) analysis. *Id.* at 26a. Finally, petitioners' allegations were not proved. The record evidence did not show either that "Harris attempted to exercise" influence

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vices were *not* indistinguishable: The "services Harris provided to institutional clients varied, but in all events *were more limited* than those they provided to the Funds." Pet. App. 16a (emphasis added). The court then noted that, *even if* the services provided were "indistinguishable," the fee differential here was not sufficient to set forth a § 36(b) violation, because "the amounts paid by different parties establish a range of prices that investors were willing to pay." *Id.* at 30a.

or that a conflict made it "impossible for the trustees to act without compromising the shareholders." *Ibid.*

Finding no disputed issue of fact as to "whether there is a fundamental disconnect between what the Funds paid and what the services were worth," the court granted summary judgment for Harris. Pet. App. 32a.

### C. The Court Of Appeals' Decision

The Seventh Circuit affirmed. Pet. App. 1a-14a. On appeal, petitioners again disavowed *Gartenberg*, and urged the court to review Harris's fees for "reasonableness" instead. *Id.* at 6a. The court of appeals expressed skepticism about *Gartenberg*, and ultimately "disapproved" its approach. But it was not persuaded to adopt petitioners' "reasonableness" requirement. The court explained that § 36(b) does not say that "fees must be 'reasonable' in relation to a judicially created standard." *Id.* at 8a. In fact, Congress had rejected a reasonableness requirement. *Id.* at 8a, 10a-11a. The statute instead imposes a fiduciary duty, which "differs from rate regulation." *Id.* at 8a. Under traditional principles, a fiduciary "owes an obligation of candor in negotiation, and honesty in performance," but may negotiate in its own interest with respect to compensation. *Id.* at 8a-9a (citing *Restatement (Second) of Trusts* § 242 & cmt. f (1959)). The court cautioned that "[i]t is possible to imagine compensation so unusual that a court will infer that deceit must have occurred, or that the persons responsible for decision have abdicated." *Id.* at 9a. But petitioners had not identified facts to support such an inference. *Id.* at 13a-14a. The Seventh Circuit thus refused to disturb the district court's conclusions that petitioners raised no material issue of fact to rebut the record of robust, informed, and independent negotiation, and that the bargain produced rates that fit comfortably within the range corroborated by the "market." *Ibid*. The court of appeals therefore affirmed the district court's judgment that Harris did not breach its "fiduciary duty with respect to the receipt of compensation." *Ibid*.

The court of appeals also refused to disturb the district court's determination that petitioners had raised no genuine dispute about the differences between fees charged to mutual funds and other clients. Pet. App. 13a. Echoing the district court's conclusion that Harris provided "more limited" services to non-mutual fund clients, *id.* at 16a, the court of appeals explained that "[d]ifferent clients call for different commitments of time," different services, and varying degrees of complexity in conducting "research, valuation and portfolio design." *Id.* at 13a. For example, "[p]ension funds have low (and predictable) turnover of assets." *Ibid.* But "[m]utual funds may grow or shrink quickly and must hold some assets in high-liquidity instruments to facilitate redemptions." *Ibid.* Like the district court, the court of appeals rejected the notion that a fiduciary duty encompasses a uniformity requirement for rates. *Ibid.*

The court also rejected the contention that the "captive" relationship between an investment adviser and a fund leads to excessive fees. Pet. App. 7a. Advisers form funds to compete for investor dollars. "[M]utual funds have a powerful reason to keep [fees] low unless higher fees are associated with a higher return on investment." *Ibid.* "That mutual funds are 'captives' of investment advisers does not curtail this competition. An adviser can't make money from its captive fund if high fees drive investors away." *Ibid.* Mutual fund investors can move their investment dollars across thousands of competing funds rapidly and easily, allowing investors to "protect their interests by shopping." *Id.* at 11a-12a. Consequently, even if funds do not fire their advisers, investors "can and do 'fire' advisers cheaply and easily by moving their money" to other funds. *Ibid.*

The court finally rejected petitioners' contentions that ostensible conflicts among the trustees amounted to violations of § 36(b). Pet. App. 3a-4a. Echoing the district court, the Seventh Circuit held that claimed violations of other sections of the ICA that do not afford a private right of action cannot be enforced under § 36(b). *Id.* at 3a. The court rejected petitioners' suggestion that one trustee (Mr. Morgenstern) was not "disinterested." Even without counting Mr. Morgenstern, the board still exceeded the statutorily required percentage of disinterested directors. *Id.* at 3a-4a. The court discredited petitioners' fallback argument that Mr. Morgenstern's social and business contacts with other trustees made him "posses[s] some Svengali-like sway over the other trustees, so that his presence in the room was enough to spoil their decisions." *Id.* at 4a.

The court of appeals denied rehearing *en banc* by an equally divided vote. The dissenting judges acknowledged that "[t]he *outcome* of this case may be correct." Pet. App. 42a. And they agreed that the panel's conclusion "might not seem to differ materially from" the *Gartenberg* standard. *Id.* at 41a. But the dissenting judges expressed concern that the panel opinion could be read to preclude courts from comparing the adviser's fee to anything but the fees charged to other mutual funds. *Ibid.*

## SUMMARY OF ARGUMENT

I. A. For nearly 30 years, the mutual fund industry and the SEC have uniformly accepted the interpretation of § 36(b)'s "fiduciary" obligation articulated in *Gartenberg* v. *Merrill Lynch Asset Management Co.*, 694 F.2d 923 (2d Cir. 1982). Under *Gartenberg*, an adviser breaches its fiduciary duty with respect to the receipt of compensation when it charges a fee that is "so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining." *Id.* at 928.

That standard is faithful to the text, structure, and history of the ICA. In enacting § 36(b), Congress drew upon the common law of fiduciary obligations, which asks whether "under all the circumstances the transaction carries the earmarks of an arm's length bargain." *Pepper* v. *Litton*, 308 U.S. 295, 306-07 (1939). Congress departed from the common law, however, by placing the burden of proof on the plaintiff. The resulting standard is precisely what *Gartenberg* enunciated, requiring the shareholder to prove that the fee could not have been the product of arm's-length bargaining. *Gartenberg*'s approach is also consistent with the ICA, which makes independent boards the "cornerstone" of its "effort to control conflicts of interest within mutual funds," *Kamen* v. *Kemper Fin. Servs.*, 500 U.S. 90, 107 (1991), and directs courts to accord board approval "such consideration * * * as is deemed appropriate under all the circumstances," 15 U.S.C. § 80a-35(b)(2).

B. Petitioners pin their entire case on the theory that adviser fees must be "fair and reasonable," and that any difference between the fees charged to mutual fund clients and institutional clients is dispositive as a matter of law.

1. Petitioners' contention that Congress imported trust-law principles of "fairness and reasonableness" into the term "fiduciary duty" is untenable. Congress knows how to incorporate trust-law concepts into a statute and did not do so here. And those concepts are incongruous

in this context, where the statute erects multiple, independent checks on excessive fees.

2. More important, Congress explicitly *rejected* the standard proposed by petitioners. In the 1970 Amendments, Congress deleted a proposed "reasonableness" standard in favor of "fiduciary duty." Congress did not reject "reasonableness" only to camouflage it in a different phrase.

3. In all events, petitioners' standard makes little practical sense. Since § 36(b)'s enactment, the SEC has further strengthened the ICA's stringent requirements for board independence. At the same time, the growth of the mutual fund industry has created a powerful check on fees: Investors are free to transfer their dollars elsewhere. Review of fees for fairness, which courts are ill-equipped to carry out, is not necessary.

C. Petitioners hinge their fairness standard on the claim that different charges to mutual fund clients and institutional clients are legally dispositive. That imposes extra-textual rate regulation in the form of a "most favored price" rule. To be sure, a comparison of fees and services may be germane in some circumstances. But that is plainly not always the case, and it depends upon apt comparisons. Petitioners did not lay the foundation of comparability, as both the district court and court of appeals found. Since the services here are not comparable, there is no justification for making the comparison dispositive.

D. Finally, petitioners assert that § 36(b) permits a cause of action where the fee is reasonable, but the fee-setting process was flawed. That finds no support in the the statute, which provides a cause of action only for breaches "with respect to the *receipt of compensation*." Congress did not establish a private right of action in

§36(b) to enforce other provisions of the ICA that do not themselves include a private right of action.

II. Petitioners' proposed standard would provoke enormously costly trials upon the bald assertion that fees were "too high" or a process was somehow flawed. That recipe for unrestrained litigation would benefit lawyers, not investors.

III. The district court properly applied *Gartenberg* to the undisputed facts, and the court of appeals properly declined to disturb those findings. Petitioners' disagreement with the factual findings of both courts supplies no reason to reverse the judgment or to uproot *Gartenberg*'s well-settled and well-respected framework.

## ARGUMENT

The Investment Company Act ("ICA") addresses investment adviser compensation through a carefully calibrated and reticulated statutory scheme. To promote robust bargaining, Congress required that management fees be approved annually by a majority of the disinterested directors. 15 U.S.C. §80a-15(a)(2), (c). The ICA and SEC regulations oblige investment advisors to provide, and mutual fund boards to review, extensive disclosures about an adviser's fees, costs, performance, and profits, as well as whether the board relied upon comparisons of the services and charges to other clients. *Id.* §80a-15(c); 69 Fed. Reg. 39,798, 39,808 (June 30, 2004). The Act thus delegates primary responsibility for investment adviser compensation to the fund's independent board members, and equips them with the tools they need to function as informed negotiators and "independent watchdogs." *Burks* v. *Lasker*, 441 U.S. 471, 484 (1979) (quoting *Tannenbaum* v. *Zeller*, 552 F.2d 402, 406 (2d Cir. 1977)).

Section 36(b) of the ICA supplements that regime by creating a remedy for an investment adviser's breach of "fiduciary duty with respect to the receipt of compensation." 15 U.S.C. § 80a-35(b). Petitioners would construe § 36(b) to impose an actionable obligation that fees be "fair and reasonable" in the eyes of a reviewing court, see Pet. Br. 38, and to authorize judicial review of flaws in negotiations detected in hindsight, *id.* at 17 (proposing two-part standard). Those constructions are untenable. Both are inconsistent with the statutory text and structure, the measure's history, and the judicial interpretation of the measure that petitioners purport to champion.

Petitioners acknowledge (Br. 44) that, when Congress imposed a "fiduciary duty with respect to compensation," it rejected prior bills that required adviser compensation to be "reasonable." See S. Rep. No. 184, 91st Cong., 1st Sess. 5-6 (1969) (noting "delet[ion]" of "reasonableness" standard and substitution of "fiduciary duty" as "a different method of testing management compensation"). But petitioners nevertheless insist that the phrase "fiduciary duty" requires fees to be "fair and reasonable." See Pet. Br. 38. They thus take the circular position that Congress implicitly encompassed within the "fiduciary duty" text it enacted the "reasonableness" standard it explicitly rejected.

Petitioners steer this circular path from the premise—ostensibly derived from the law of trusts—that the compensation of "fiduciaries" is always susceptible to judicial review to determine whether it is "fair and reasonable." That is wrong. But in all events, Congress did not transplant fiduciary compensation principles into § 36(b) wholesale from the particularized context of trust law. It created a "unique" right, enforceable by the SEC and security holders, *Daily Income Fund* v. *Fox*, 464 U.S. 523, 524 (1984), that both drew upon and modified general fiduciary principles with common-law roots from multiple sources.

The general standard of fiduciary obligation at common law is well established. The "essence of the test" is whether, "under all the circumstances," the result "carries the earmarks of an arm's length bargain." *Pepper* v. *Litton*, 308 U.S. 295, 306-07 (1939). In § 36(b), Congress adopted that familiar standard and adapted it to the mutual fund context. At common law, a fiduciary was obliged to justify his fee; in § 36(b)(1), Congress reversed the burden of proof and put the onus on the shareholder. 15 U.S.C. § 80a-35-b(1). Common law likewise deferred in the corporate context to board decisions with scant regard to the quality of their deliberations. See, *e.g.*, *Saxe* v. *Brady*, 40 Del. Ch. 474, 486 (1962); S. Rep. No. 184, *supra*, at 5. In § 36(b)(2), Congress commanded that courts "shall" give board approval the deference that is due "under all the circumstances." 15 U.S.C. § 80a-35(b)(2). In short, Congress borrowed the familiar "earmarks of an arm's length bargain" test from common law, and turned it around to oblige a shareholder to show that the fee could *not* have been the product of an arm's length bargain.

That is precisely what the Second Circuit held in *Gartenberg* v. *Merrill Lynch Asset Management, Inc.*, 694 F.2d 923 (2d Cir. 1982). To violate § 36(b), *Gartenberg* stated, "the adviser-manager must charge a fee that is *so disproportionately large that* it bears no reasonable relationship to the services rendered and *could not have been the product of arm's-length bargaining*." *Id.* at 928 (emphasis added). *Gartenberg*'s holding was thus faithful to the statutory "fiduciary duty 'standard,'" as well as to the statute's directive that courts "shall" accord "approval by the [mutual fund's] board of directors * * * such consideration * * * as is deemed appropriate under all the circumstances." 15 U.S.C. § 80a-35(b)(2). *Gartenberg* honors Congress's intent that the judiciary not "substitute its business judgment for that of the mutual fund's board of directors in the area of management fees." S. Rep. No. 184, *supra*, at 6.

Petitioners purport to embrace *Gartenberg*, observing that it "correctly held" that an adviser violates § 36(b) "when it charges a fee that exceeds what could be obtained in an arm's length transaction." Pet. Br. 18. But that about-face from their position in both courts below, see pp. 13, 16, *supra*, is suspiciously selective. Petitioners reject *Gartenberg's* holding—that an adviser "must charge a fee that is so disproportionately large" that it "could not have been the product of arm's length bargaining." Pet. Br. 31 (describing that formulation as "erroneous"). They likewise refuse to accept factors in the "disproportionality" calculus that *Gartenberg* identified as most relevant. Petitioners acknowledge, for example, that "*Gartenberg* 'rejected' a comparison between the fees charged to the money-market fund at issue there and the fees charged to" institutional accounts because (among other things) the institutional accounts "did not 'face the myriad daily purchases and redemptions throughout the nation which must be handled' by the money-market fund." *Id.* at 30 (quoting 694 F.2d at 930 n.3). But petitioners press a similarly inapt comparison on this Court, asking it to equate managing investments for a single institutional account with the sponsorship, operation and management of a mutual fund with hundreds of thousands of investors, related infrastructure and support requirements, daily cash-flow needs, and significant regulatory obligations—none of which exist for institutional accounts. Indeed, they insist that this Court make such a comparison the overriding consideration as a matter of law, from their question presented forward. Pet. Br. i, 30-31, 48-50. And they layer onto their ersatz espousal of *Gartenberg* the separate contention—found nowhere in *Gartenberg* much less the statute—that an adviser can independently violate § 36(b) through negotiation "process" flaws. Pet. Br. 17, 18, 25, 33. Petitioners thus ask this Court to adopt everything in *Gartenberg* except its holding and analysis.

Respondent agrees with the United States that *Gartenberg* supplies the relevant standard for measuring violations of § 36(b). See U.S. Br. 11-12 (*Gartenberg* "provides the appropriate way to resolve § 36(b) cases"). But *Gartenberg* did not adopt the "reasonableness" standard petitioners propose. This Court should reject petitioners' circular reading of text, their failure to acknowledge statutory structure and history, and their unaffectionate embrace of *Gartenberg.*

## I. A MUTUAL FUND ADVISER BREACHES ITS FIDUCIARY DUTY WITH RESPECT TO COMPENSATION ONLY IF IT CHARGES A FEE THAT IS SO DISPROPORTIONATE IT COULD NOT HAVE BEEN THE PRODUCT OF ARM'S-LENGTH BARGAINING

Section 36(b) by its terms provides that investment advisers have a "fiduciary duty with respect to the receipt of compensation." 15 U.S.C. § 80-35(b). For nearly 30 years, the "fiduciary" obligation that provision establishes has enjoyed a common understanding by advisers, fund boards, shareholders, regulators and courts. Since the Second Circuit's decision in *Gartenberg*, the industry and the SEC alike have uniformly accepted that, to breach its "fiduciary duty with respect to compensation," an adviser must charge a fee that is "so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining." 694 F.2d at 928. *Gartenberg's* broad acceptance is attributable to its consistency with the text, structure, and history of the ICA.

Petitioners schizophrenically claim to endorse *Gartenberg* as "correct," Pet. Br. 18, while simultaneously rejecting its "so disproportionate" standard as "erroneous," *id.* at 31. They propose instead that courts subject fees to "rigorous scrutiny" to ensure that management fees are "fair" and "reasonable." *Id.* at 17, 31. And they inject an altogether new "fair process" ingredient to the text's cause of action for improper "receipt" of "compensation." *Id.* at 17, 18, 25, 33. Petitioners thus would have courts examine fees for "reasonableness" and require judicial micromanagement of the fee-negotiating "process," authorizing a remedy even if a flaw detected in hindsight did not impact the result.

Petitioners' proposed replacement of *Gartenberg's* long-established standard with a formula of their own creation is flatly contrary to § 36(b)'s text and the ICA's structure. It would afford any plaintiff—including shareholders who knowledgeably bought their shares on full disclosure of fees—the ability to force a trial for a judge to decide after-the-fact if fees were just "too high." That is a recipe for unrestrained litigation that the statute did not countenance and this Court should not provoke.

### A. *Gartenberg*'s "So Disproportionate" Test Properly Interprets § 36(b)'s Text And Structure

In enacting § 36(b)'s "fiduciary duty with respect to the receipt of compensation," Congress consciously navigated between two extremes. On the one hand, Congress rejected the "reasonableness" standard initially proposed by the SEC and passed by the Senate. *Daily Income*

*Fund*, 464 U.S. at 538-39; S. Rep. No. 184, *supra*, at 5; H.R. Rep. No. 2337, 89th Cong., 2d Sess. 142-44 (1966). That test was "offensive to many" because it smacked of "fee-setting" and authorized courts to "substitute" their judgment for and "supersede" decisions of informed boards. 115 Cong. Rec. 13,693 (May 26, 1969). On the other hand, Congress concluded that prevailing "waste" standards were "unduly restrictive" because they prevented only shocking fees and accorded near-absolute deference to board approval. S. Rep. No. 184, *supra*, at 5. Congress therefore created a "unique" right, *Daily Income Fund*, 464 U.S. at 524, by adopting a federally-created "fiduciary duty" standard with common-law roots. In adopting a phrase with common-law origins, however, Congress did not transplant into the statute the specific law of trusts, as petitioners contend. It drew on general fiduciary principles that married content to context. And it modified those principles to tailor them to "the unique structure of mutual funds." S. Rep. No. 184, *supra*, at 2; see *id.* at 5.

1. This Court interprets statutes in light of "text, structure, purpose, and history." *General Dynamics Land Sys., Inc.* v. *Cline*, 540 U.S. 581, 600 (2004). *Gartenberg*'s interpretation of § 36(b)'s "fiduciary duty with respect to the receipt of compensation" reflects the statute's text and is faithful to congressional intent. Where, as here, the statute invokes terms with settled common-law meanings, this Court assumes Congress intended to incorporate those meanings except as the statutory text, structure, or context otherwise indicates. *Neder* v. *United States*, 527 U.S. 1, 21 (1999). As *amicus curiae* Securities Industry and Financial Markets Association ("SIFMA") explains at length, the common law of "fiduciary duties" related to compensation is extensive, varied,

and context-sensitive; its standards are adaptable in light of the nature of the fiduciary relationship, the source of the obligation, the parties' bargaining power, and other factors. But all parties and the United States agree that the fundamental consideration was expressed by this Court in *Pepper* v. *Litton*, 308 U.S. 295 (1939): "The essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain." *Id.* at 306-07; see U.S. Br. 11; Pet. Br. 23-25. Because a fiduciary bore the burden of proof at common law,[4] the principle drawn from *Pepper* would oblige an investment manager to justify its fees as falling within the range that informed bargaining would produce. Section 36(b)(1), however, reverses the common-law burden of proof. The statute puts the onus on the challenger, declaring that "the plaintiff shall have the burden of proving a breach of fiduciary duty." 15 U.S.C. § 80a-35(b)(1). As a result, the shareholder must prove that, under "all the circumstances," an investment adviser has charged fees that do *not* "carr[y] the earmarks of an arm's length bargain." *Pepper*, 308 U.S. at 306-07.

*Gartenberg* imposes precisely that requirement. It assigns to a shareholder the responsibility to demonstrate that an adviser's fee is "so disproportionate" that it "could not have been the product of arm's-length bargaining." *Gartenberg*, 694 F.2d at 928. *Gartenberg* thus incorporates *Pepper*'s "essen[tial] * * * test" of an "arm's-length bargain," and implement's § 36(b)(1)'s directive to reverse the burden of proof.

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[4] At common law, a fiduciary ordinarily bore the burden of justifying its fees if challenged. See, *e.g.*, *Pepper*, 308 U.S. at 306; cf. *Geddes* v. *Anaconda Copper Mining Co.*, 254 U.S. 590, 599 (1921) ("[W]here the fairness of such transactions is challenged the burden is upon those who would maintain them * * * .").

2. The *Gartenberg* formulation, moreover, properly incorporates the other features of the statutory text that adapt fiduciary principles to the mutual fund context. When plotting the course between "reasonableness" and "waste," Congress rejected waste-based standards that accorded extreme deference to boards even if they rubber-stamped the adviser's request. S. Rep. No. 184, *supra*, at 5. Congress departed from unqualified respect for board conduct and commanded that courts "shall" give board approval "such consideration by the court as is deemed appropriate under all the circumstances." 15 U.S.C. § 80a-35(b)(2).

That directive reflects the ICA's overall structure, which makes independent boards "the cornerstone of the ICA's effort to control conflicts of interest within mutual funds," *Kamen* v. *Kemper Fin. Servs.*, 500 U.S. 90, 107 (1991) (quoting *Burks*, 441 U.S. at 482), and interposes them as "independent checks" against excessive fees, *Daily Income Fund*, 464 U.S. at 540. As explained above, the ICA mandates that 40 percent of a board's fund members be "disinterested" with respect to the investment adviser and that any agreement with the investment adviser be approved every year by a majority of disinterested board members. See 15 U.S.C. §§ 80a-10(a), 15(c). "Congress' purpose in structuring the Act this way is clear. It placed the unaffiliated directors in the role of 'independent watchdogs,' who would 'furnish an independent check upon the management' of investment companies." *Burks*, 441 U.S. at 484 (citations omitted). The Act also requires investment advisers to provide, and boards to review, a wealth of materials to assist in their annual contract evaluation. See p. 4, *supra*. That statutory process yields vast amounts of information that would rarely be available in a typical arm's-length negotiation. No arm's length negotiator would typically know its counterparties' costs, profits, and agreements with other companies. But mutual fund boards do. Fund boards negotiate from a position that is *better* than arm's-length. They have the independence they need to make demands, and superior information that gives them an advantage other negotiators customarily lack.

Section 36(b)(2) reflects the board's "cornerstone" role in the statutory structure. Departing from the common law, that provision's directive that courts give the board's determination the weight it is due proposes that courts ask whether "deliberations * * * were a matter of substance or a mere formality." H.R. Rep. No. 1382, 91st Cong., 2d Sess. 37 (1970); S. Rep. No. 184, *supra*, at 15. But where fund directors engage in substantive review, courts should respect their primacy as "independent watchdogs." *Burks*, 441 U.S. at 484. It is precisely because of that primacy that the court is not authorized "to substitute its business judgment for that of the mutual fund's board of directors." S. Rep. No. 184, *supra*, at 6. In short, courts need not defer to directors who are asleep at the wheel, but judges cannot "shift the responsibility for managing an investment company in the best interests of its shareholders from the directors of such company to the judiciary." *Id.* at 7.

*Gartenberg's* appropriation of *Pepper*'s "earmarks of an arm's-length bargain" properly applies § 36(b)(2)'s directive. *Gartenberg* captures the deference that federal courts owe to the business judgment of the board while making clear that deference is not owed to directors who fail to engage in substantive review. 694 F.2d at 930. And it properly reflects the Act's structural delegation of primary responsibility to directors and the proscription on courts' exercising independent business judgment.

3. *Gartenberg* has been consistently applied. Courts in the First, Second, Third, Fourth, Fifth, and Ninth Circuits have cited *Gartenberg* as authority, often adopting its standard and factors explicitly.[5] That near-universal acceptance over a period spanning 25 years is unsurprising given *Gartenberg*'s origins in familiar fiduciary concepts, as modified by Congress for application in the mutual fund context.

The SEC has also effectively adopted *Gartenberg* as the embodiment of § 36(b)'s "fiduciary duty." As the Solicitor General explains, "[t]he SEC's regulations have recognized, and formalized, *Gartenberg*-like factors." U.S. Br. 23; see, *e.g.*, *Disclosure Regarding Approval of Investment Advisory Contracts by Directors of Investment Companies*, 69 Fed. Reg. 39,798, 39,807-09 (2004) (requiring discussion of *Gartenberg*-like factors in mutual fund disclosures about fees). Indeed, the Commission has frequently cited *Gartenberg* to suggest that fees "must fall within the range of what would have been negotiated by the parties at arm's length." SEC No-Action

[5] See, *e.g.*, *Forsythe* v. *Sun Life Fin., Inc.*, 417 F. Supp. 2d 100, 114 (D. Mass. 2006) ("In *Gartenberg*, the Second Circuit set forth a standard that has since been widely cited by other courts in addressing claims under § 36(b)."); *Yameen* v. *Eaton Vance Distrib.,* 394 F. Supp. 2d 350, 355 (D. Mass. 2005) (applying *Gartenberg*); *Amron* v. *Morgan Stanley Inv. Advisers, Inc.*, 464 F.3d 338, 340-41 (2d Cir. 2006) (applying *Gartenberg*); *In re Franklin Mut. Funds Fee Litig.*, 478 F. Supp. 2d 677, 686 (D.N.J. 2007) (applying *Gartenberg*); *Migdal* v. *Rowe Price-Fleming Int'l, Inc.*, 248 F.3d 321, 326 (4th Cir. 2001) (describing *Gartenberg* as having "exhaustively analyzed Section 36(b)" and citing its standard); *Hunt* v. *Invesco Funds Group, Inc.*, No. 04-2555, 2006 WL 1581846, at *2 (S.D. Tex. June 5, 2006) (applying *Gartenberg*); *Siemers* v. *Wells Fargo & Co.*, No. 05-4518, 2006 WL 2355411, at *15-16 (N.D. Cal. Aug. 14, 2006) (applying *Gartenberg*).

Letter, Norwest Bank Minnesota, 1995 WL 329622, at *4 (May 25, 1995) (citing *Gartenberg*).

Thus, as Commissioner Troy Peredes recently observed, "*Gartenberg* has long served as a constructive focal point for the mutual fund industry, as norms and practices have developed around the *Gartenberg* factors * * *. Even the SEC has incorporated *Gartenberg* in its rulemaking." Speech by SEC Commissioner: Remarks Before the Mutual Fund Directors Forum Ninth Annual Policy Conference (May 4, 2009), *available at* http://www.sec.gov/news/speech/2009/spch050409tap.htm; see also SEC Div. of Inv. Mgmt., *Report on Mutual Fund Fees and Expenses* (Dec. 2000), *available at* http://www.sec.gov/news/studies/feestudy.htm (in §36(b) cases, courts determine whether the adviser charged a fee "that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining"); SEC Div. of Inv. Mgmt., *Protecting Investors: A Half Century of Investment Company Regulation* (May 1992), *available at* http://www.sec.gov/divisions/investment/guidance/icreg5092.pdf (*Gartenberg* "remains the leading authority for evaluating an adviser's breach of fiduciary duty with regard to compensation"). The *Gartenberg* standard and factors likewise have been adopted throughout the industry because they "provide[] useful guidance to fund boards fulfilling their obligation under Section 15(c) of the ICA of evaluating advisers' compensation" as well as "guidance for advisers in proposing fees." U.S. Br. 24.

### B. Petitioners' Proposed "Fair And Reasonable" Standard Is Inconsistent With §36(b)'s Text, Structure, And History

In contrast to *Gartenberg*'s requirement that fees be "so disproportionate" they "could not have been" the product of arm's-length bargaining, petitioners propose that federal courts subject advisory fees to "rigorous scrutiny" to ensure that they are "fair and reasonable." Pet. Br. 17, 25, 28, 31, 33. That open-ended license for judicial revision to adviser compensation is precisely what Congress rejected. The text, structure, and history of § 36(b) all show petitioners' approach to be untenable. It is not surprising that no court has ever adopted petitioners' approach.

1. *Section 36(b)'s Text and Structure Defy Petitioners' Construction*

Petitioners' "fair and reasonable" standard proceeds from the indefensible premise that Congress incorporated principles drawn from the specialized law of trusts, and transplanted them wholesale by using the words "fiduciary duty." Pet. Br. 20-25. To be sure, "[w]here Congress uses terms that have accumulated settled" common-law meaning, "a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms." *Id.* at 20 (quoting *Neder* v. *United States*, 527 U.S. 1, 21 (1999)). But the phrase "fiduciary duty" does not refer only to the common law of trusts. The scope of any fiduciary obligation derives from its context. Cf. *SEC* v. *Chenery Corp.*, 318 U.S. 80, 85-86 (1943) ("[T]o say that a man is a fiduciary only begins analysis; it gives direction to further inquiry.") (emphasis added). Different fiduciary contexts may require different compensation rules; courts reject thoughtless transplantation. See, *e.g.*, *Mfrs. Trust Co.* v. *Becker*, 338 U.S. 304, 311-12 (1949) (declining to apply trust law concepts to directors of insolvent corporation). Even petitioners' *amici* agree. See Br. of Professors DeMott and Ascher 4 ("Fiduciary doctrine is not monolithic in its operation. Thus, the duty of loyalty applicable to some fiduciaries operates with greater stringency.").

Petitioners identify nothing in § 36(b)'s text that signals an intent to import the law of trusts into judicial review of investment adviser compensation. Neither the statute nor its legislative history invoke—or even mention—trust law. Surely Congress knows how to incorporate trust concepts into a statute; it has often done so. See, *e.g.*, 29 U.S.C. § 1103(a) (ERISA defines plans as "held in trust," appoints administrator as "trustee," and mandates "trustees" be "named in the trust"); *Cent. States, Se. & Sw. Areas Pension Fund* v. *Cent. Transp., Inc.*, 472 U.S. 559, 570 (1985) (ERISA "invoked the common law of trusts to define the general scope" of the "powers and duties of trustees and other [ERISA] fiduciaries"). But it did not do so here, either expressly or by implication.

If Congress had intended to incorporate a specific trust-law standard, it could have required investment adviser compensation to be "fair" or "reasonable." It did precisely that in *other* provisions of the ICA. See, *e.g.*, 15 U.S.C. § 80a-17(b) (authorizing transactions with affiliates only if "the terms * * * , including the consideration to be paid or received, are *reasonable and fair* and do not involve overreaching on the part of any person concerned") (emphasis added); *id.* § 80a-26(f)(2)(A) (registered account funding variable insurance contracts is permitted only if "the fees and charges * * *, are *reasonable* in relation to the services rendered, the expenses expected to be incurred, and the risks assumed by the insurance company" or if other conditions are met) (emphasis added); *id.* § 80a-27(a)(5) & (6) (fees for periodic payment plan certificates must not "exceed[] such *reasonable amount* as the Commission may prescribe") (emphasis added); see also 15 U.S.C. § 80a-10(d)(6) (capping fees in certain situations). The use of the terms "fair" and "reasonable" elsewhere in the ICA—but *not* in § 36(b)—is compelling evidence that Congress did not incorporate "reasonableness" review into advisory compensation claims. *Bates* v. *United States*, 522 U.S. 23, 29-30 (1997) ("[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.").

Petitioners' claim that § 36(b) imports trust-law concepts is also irreconcilable with the ICA's structure, which makes independent and informed board members "the cornerstone of the ICA's effort to control conflicts of interest within mutual funds," *Kamen*, 500 U.S. at 107, and an "independent check[]" on excessive advisory fees, *Daily Income Fund*, 464 U.S. at 540. Section 36(b)(2)—which petitioners virtually erase from the text—instructs courts to accord board determinations the weight due under the circumstances. 15 U.S.C. § 80a-35(b)(2). But if the standard for judicial review were "reasonableness," Congress would have had no reason to issue that command of deference. Section 36(b)(2) was necessary only because Congress rejected "waste" standards that discounted board deliberations. A "reasonableness" standard that lies in the eyes of the judicial beholder makes § 36(b)(2) meaningless. A court cannot simultaneously comply with the statutory directive that it "shall" give directors' decisions such deference as they are due, and decide for itself whether fees are too high, too low, or just right—which is what review for "reasonableness" necessarily connotes.

The ICA's independence and disclosure requirements together promote robust negotiations that are *better* than bargains reached at arm's-length. In sharp contrast, in the trust-law context, judicial scrutiny of "fairness" was warranted when expert and independent negotiators did *not* exist to protect the beneficiary's interests. See, *e.g.*, *Restatement (Second) of Trusts* § 242 & cmt. f (1959). It is inconceivable that Congress transplanted trust law into this foreign soil without saying so.

2. *The Act's History Refutes Petitioners' Construction*

Congress specifically considered and rejected the standard of reasonableness that petitioners propose. See *Daily Income Fund*, 464 U.S. at 538-39. In 1968, at the SEC's urging, see H.R. Rep. No. 2337, *supra*, at 142-44, the Senate passed a bill that would have required mutual fund advisory fees to be "reasonable" and granted shareholders standing to enforce that obligation. S. Rep. No. 184, *supra*, at 5. But in the 1970 Amendments, Congress dropped the "reasonableness" requirement. *Ibid.* By espousing "reasonableness" as their touchstone, petitioners contend that Congress explicitly rejected that standard only to adopt it *sub silentio* within the phrase "fiduciary duty."

But Congress did not enact circular synonyms. It specifically "substitute[d]" "reasonableness" with "fiduciary duty" as a "*different* method of testing management compensation." S. Rep. No. 184, *supra*, at 5 (emphasis added). "Congress consciously chose to address the conflict-of-interest problem through the Act's independent-directors section, rather than through more drastic remedies" such as reasonableness review. *Burks*, 441 U.S. at 483; see also *id.* at 484 ("Congress turned not to direct controls, but rather to stiffening the requirement of independence as the way to remedy the act's deficiencies." (citations omitted)). Petitioners' proposed standard would replace that legislative resolution with the sort of judicial second-guessing that Congress rejected.

As the United States explains, Congress's decision to use the words "fiduciary duty" rather than "reasonableness" reflects its intent to preclude judges from serving as "super-trustees" or ratemakers. See U.S. Br. 23 n.6; S. Rep. No. 184, *supra*, at 6 ("Nothing in this bill is intended to * * * suggest that a 'cost-plus' type of contract would be required" or "to introduce general concepts of rate regulation * * * "). And for good reason. Federal courts are ill-equipped to engage in the sort of rate regulation petitioners propose. *Pac. Bell Tel. Co.* v. *LinkLine Commc'ns*, 129 S. Ct. 1109, 1121-22 (2009); *Verizon Commc'ns* v. *FCC*, 535 U.S. 467, 539 (2002); *Town of Concord* v. *Boston Edison Co.*, 915 F.2d 17, 25 (1st Cir. 1990) (Breyer, C.J.) ("[H]ow is a judge or jury to determine a 'fair price'?"). Petitioners' "fair and reasonable" standard flatly contradicts the construction the United States proposes.

3. *Petitioners' Fairness Standard Makes Little Sense in Light of Regulatory and Market Developments Since the ICA's Enactment*

Petitioners' "fair and reasonable" standard is also nonsensical as a practical matter. Since § 36(b)'s enactment (and even since *Gartenberg* was decided), the SEC has further reinforced the ICA's already "strengthened" requirements for board independence. *Daily Income Fund*, 464 U.S. at 538. The SEC has fleshed out the general disclosure-and-approval provisions of § 15(c) by requiring boards to disclose to shareholders their consideration of the *Gartenberg* factors and the weight they accorded them. SEC, Disclosure Regarding Approval of Investment Advisory Contracts by Directors of Investment Companies (June 23, 2004), http://www.sec.gov/rules/final/33-8433.htm. The business judgment of a board that complies with the SEC's comprehensive regulatory requirements thus will be entitled to substantial deference under § 36(b)(2). It would be a monumental waste of judicial and private resources to subject fund advisers to *de novo* relitigation of the very factors already considered by an independent and informed board.

The growth of an extraordinarily competitive mutual fund market also militates against reading the term "fiduciary duty" to impose judicial rate regulation. Thousands of mutual funds compete for investor dollars. Dissatisfied investors are free to transfer their dollars elsewhere. And empirical evidence shows that they often do, as low-fee funds have experienced tremendous growth, while higher-fee funds have shrunk. Growth, in turn, has prompted a steep and steady decline in fees across the industry. See p. 7, *supra*. In light of that fierce competition, charging fund fees that are generally consistent with comparable funds cannot reasonably be thought to be overreaching. Cf. William A. Gregory, *The Law of Agency and Partnership* § 87 (3d ed. 2001) (absent agreement, courts look to market rates to set fiduciary compensation). Rate regulation may be proper for other industries like utilities or natural monopolies. But it is inconceivable that Congress meant to inflict it on a competitive market under the auspices of an adviser's "fiduciary duty."

### C. Comparison with Institutional Clients Is Relevant Only When the Adviser Provides Comparable Services

A cornerstone of petitioners' position is that a plaintiff can prove a § 36(b) claim by showing that an adviser charges more to mutual fund clients than to institutional clients like pension funds. Pet. Br. i, 30-31, 48-50. But that effort to require equal charges to different clients suffers from twin defects. First, it betrays petitioners' "reasonableness" test as an undisguised effort to impose judicial rate regulation. Second, it rests upon the rickety foundation that services to disparate clients are comparable. The first proposition we have shown to be inconsistent with legislative text, structure and history. See pp. 33-38, *supra.* The latter notion was rejected on undisputed facts by the district court, and left undisturbed by the court of appeals. The same contention has frequently been advanced and rejected by other courts, including *Gartenberg*, 694 F.2d at 930 n.3.

The district court and court of appeals both perceived that institutional-client fees are potentially probative only if the services provided to the mutual fund and the institutional client are comparable. The district court held that petitioners failed to raise a triable dispute on that issue. Pet. App. 16a ("The services Harris provided to institutional clients varied, *but in all events were more limited* than those they provided to the Funds.") (emphasis added). The district court further held that, *even if* the services were comparable, the difference in fees was insufficiently large to demonstrate a breach of § 36(b)'s fiduciary duty. *Id.* at 30a. Rather, together with fees charged by other advisers to comparable mutual funds, the fees charged to institutional clients demonstrated the range of fees that investors were willing to pay. *Ibid.* Because Harris's fees fell within that range, the district court correctly concluded that the fees were not so disproportionate as to evidence a lack of arm's length bargaining. *Ibid.*

The court of appeals agreed that the services Harris provided to institutional clients were not comparable and therefore found the price differential irrelevant. "Different clients call for different commitments of time. Pension funds have low (and predictable) turnover of assets. Mutual funds may grow or shrink quickly and must hold some assets in high-liquidity instruments to facilitate redemptions." Pet. App. 13a. Petitioners' disagreement is thus with both lower courts' determinations that the services were not comparable, not with any legal standard that excludes consideration of institutional-client fees.

Petitioners' claims that the institutional-client comparison is "highly probative" and "highly pertinent," Pet. Br. 31, thus cannot apply in all cases, or even most. Section 36(b) provides no mandate for courts to demand that mutual fund fees match some institutional fee. And the "most-favored-pricing" rule that petitioners seek to impose ignores the substantial differences that exist between mutual funds and other accounts. To be sure, an investment adviser provides portfolio management services for both types of accounts, including security selection, research, trading and asset allocation. See J.A. 145. But the similarities largely end there. See Investment Company Institute, *Mutual Funds and Institutional Accounts: A Comparison* 1, 7 (2006) ("Comparison Study"), 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. In addition to portfolio management, Harris provides a host of services that are unique to its role as the sponsor and manager of the Oakmark family of mutual funds. These include, among other things, administrative services; shareholder communications, including the preparation and distribution of prospectuses and periodic reports; oversight of third-party vendors, including the transfer agent, custodian, and intermediaries; trustee support, including preparation of materials for board meetings; tax administration; and compliance with a complex regulatory regime that is not required for institutional accounts. J.A. 145.

Even those different services do not fully catalog the differences between clients, services, and costs that may impact fees. Mutual funds serve thousands to millions of investors with small individual accounts; institutional accounts by definition serve few investors with large balances. See Comparison Study at 4. The scope of mutual fund regulation is extensive. The ICA and other federal securities laws subject funds and their advisers to broad compliance and regulatory obligations. In addition to periodic disclosure requirements, funds must be priced daily, comply with a range of portfolio limitations and restrictions (*e.g.*, "fundamental" objectives, concentration requirements, limits on illiquid holdings, and restrictions on affiliate transactions), comply with Sarbanes-Oxley, and disclose proxy votes. *Id.* at 6. Significantly, those requirements pose legal and business risks to investment advisers they do not face from institutional accounts. Even portfolio management is different, as mutual funds are subject to large and uncertain cash flows, must meet daily redemption demands, and are actively managed to minimize taxable distributions to shareholders. *Id.* at 6-7. In the face of such disparities—which the Funds' trustees specifically reviewed, see J.A. 146, 161-81—petitioners' claim that price discrepancies should be dispositive is indefensible.[6]

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[6] It is therefore unsurprising that courts have consistently refused to find the comparison apt. See, *e.g.*, *Gartenberg*, 694 F.2d at 930 n.3; *Kalish* v. *Franklin Advisers, Inc.*, 742 F. Supp. 1222, 1237 (S.D.N.Y.

That is not to say that a comparison is always irrelevant. Once the foundational predicate of comparability is established, such a review may be germane. For precisely that reason, the independent directors in this case *did* evaluate data to weigh institutional services and fees against mutual fund counterparts. J.A. 146, 152-81. Petitioners' insistence that courts must reweigh a comparison the board has already considered illustrates the defect in their position—they seek to replace the board's judgment with a court's, precisely the result Congress sought to avoid.

The United States agrees that the comparison must be taken on a case-by-case basis, see U.S. Br. 20-21, 30-32, but criticizes the district court for treating similarities with other mutual funds as "dispositive," *id.* at 31. That misdescribes what the district court did. The district court examined the comparison between mutual fund and institutional account fees, and concluded on the undisputed facts that the services were different. Harris supplied "more limited" services to institutional clients than it provided to the Funds. Pet. App. 16a. But the district court did not consider the dissimilarity dispositive. Rather, it considered the difference in light of "all the circumstances," including the board's process and independence. *Id.* at 30a-32a (describing board processes). Finally, rather than hinging its conclusion on the different services, the court held that, "even if" one assumed

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1990) ("Under the cases, to the extent that comparisons are probative at all, a mutual fund adviser-manager must be compared with members of an appropriate universe: adviser-managers of similar funds."); *Schuyt* v. *Rowe Price Prime Reserve Fund, Inc.*, 663 F. Supp. 962, 974 n.38 (S.D.N.Y. 1987) (finding that "the types of services provided by the Adviser to the Fund and private counsel clients differ substantially").

services to be identical, the evidence did not show that the fees paid by the Funds exceeded the amount that could have resulted from arm's-length negotiations. The Funds' fees fell comfortably within the range of all fees Harris received from *all* types of clients. *Id.* at 30a.

To the extent the United States disagrees with the district court's application of the summary judgment standard, that criticism is not justified by the record. The petitioners' "evidence" of comparability sought to equate each of the Funds—with varying asset levels, distinct investment strategies, and different service requirements—to a *single*, allegedly comparable institutional account. J.A. 356. And petitioners ignored any services provided to the mutual funds that were different from or in addition to those rendered to the institutional account. *Id.* at 161-82. If the weight to be given to the comparison with institutional accounts must be determined on a case-by-case basis, this case is the poster child for affording the comparison no weight.

As the United States acknowledges (Br. 26, 30), Congress was well aware that advisers often charged institutional clients lower fees than mutual funds, and that they did so because mutual funds require additional services. See *Daily Income Fund*, 464 U.S. at 537. Indeed, the SEC's 1966 Report to Congress explained that advisers charge mutual funds higher fees because "[p]ublicly held mutual funds *require certain services that are not needed by other purchasers of investment advice.*" H.R. Rep. No. 2337, *supra*, at 11 (emphasis added); see *id.* at 116, 120-21. Yet Congress stated that the amendments to § 36 were *not* "intended to provide a basis * * * to undertake a general revision of the practices or structures of the investment company industry." H.R. Rep. No. 1382, *supra*, at 37.

Petitioners' suggestion that federal courts should parse the complex and varied services provided to different clients, allocate joint costs between clients, and then determine whether the fees charged to the funds are "fair," assigns to judges a task they are ill-equipped to execute. As the United States also recognizes, SEC regulations now require boards to disclose to shareholders the weight they accord comparative fees charged to institutional clients during the fee-approval process. U.S. Br. 30. Under § 36(b)(2), expert boards—not federal courts—are entrusted to evaluate this data in the first instance.

**D. Petitioners' Proposed Fair-Process Test Is Unsupported by § 36(b)'s Text**

In addition to claiming that § 36(b) obliges federal courts to determine if adviser *fees* are "fair," petitioners assert that § 36(b) authorizes a remedy if an adviser failed to make "full disclosure [to the board] and ensure that the dealings are fair." Pet. Br. 18. Petitioners argue that nearly every court in the decades following *Gartenberg* misconstrued that decision by requiring plaintiffs to actually prove excessive *fees*, as opposed to some flaw in the fee-setting *process*. Petitioners again ignore statutory text and structure.

1. Section 36(b) creates a "fiduciary duty with respect to *the receipt* of compensation" and a corresponding cause of action "for breach of fiduciary duty in respect of *such compensation*." 15 U.S.C. § 80a-35(b). The statutory obligation, by its terms, does not extend to the process of disclosure and negotiation by which fees are approved. "As the statutory text indicates, Section 36(b) is sharply focused on the question of whether the fees themselves were excessive." *Migdal* v. *Rowe Price-Fleming Int'l, Inc.*, 248 F.3d 321, 328 (4th Cir. 2001)

(Wilkinson, C.J.). Only the *receipt* of disproportionate compensation can violate the § 36(b) duty. An imperfect process that does not result in the receipt of disproportionate fees cannot give rise to a claim under § 36(b). *Id.* at 329 ("General breach of fiduciary duty claims which involve merely an incidental or speculative effect on advisory fees are not properly within the scope of Section 36(b).").

By misreading the statutory text, petitioners would create a cause of action that Congress declined to provide. The ICA regulates the negotiation process in multiple ways, and the 1970 Amendments "strengthen[ed]" that process by enhancing board independence and supplying tools to assist boards to do their jobs. See p. 4, *supra*. In particular, § 15(c) of the ICA requires investment advisers to disclose to the board all the information necessary to evaluate the terms of any advisory contract. 15 U.S.C. § 80a-15(c); p. 4, *supra*. But Congress did not establish a private right of action for breach of § 15(c)'s disclosure obligation. Rather, Congress left enforcement of that requirement in the hands of the SEC. 15 U.S.C. § 80a-41. Petitioners' argument effectively asks this Court to imply a private right of action to enforce § 15(c)'s obligations through § 36(b)—even though Congress could have but chose not to provide a private cause of action under § 15(c) itself. Cf. *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 571-72 (1979) (no private right of action available where Congress did not provide one, particularly where the provision at issue "is flanked by [other] provisions * * * that explicitly grant private causes of action"); *Transam. Mortgage Advisors* v. *Lewis*, 444 U.S. 11, 20-21 (1979) (no private right of action under IAA).

Section 36(b)(3), moreover, limits "[a]ny award * * * to the *actual damages* resulting from the breach of fiduciary duty." 15 U.S.C. § 80a-35(b)(3) (emphasis added). The statute links a "breach of fiduciary duty with respect to the *receipt* of compensation" to measurable damage. Petitioners' claim to a remedy for ostensible "process" flaws the district court held not to exist, and without a measurable fee impact, runs afoul of that statutory limit. Cf. *Doe* v. *Chao*, 540 U.S. 614, 621 (2004) (allowing plaintiff to recover under "actual damages" provision without proving damages would be "at odds with the traditional understanding that tort recovery requires not only wrongful act * * * but proof of some harm for which damages can reasonably be assessed").

Congress provided a different enforcement scheme for adviser misconduct unrelated to a fee itself by investing sole enforcement authority in the SEC. Section 36(a) authorizes the SEC to address breaches of fiduciary duty that involve "personal misconduct." 15 U.S.C. § 80a-35(a). And that measure expressly targets both investment advisers and board members—both participants in the fee-setting process. The SEC's enforcement arsenal for combating negotiation flaws, including misleading disclosures, also includes other provisions of the ICA and IAA. See, *e.g.*, *In re New York Life Inv. Mgmt. LLC*, Release Nos. 2883 & 28747 (May 27, 2009), *available at* www.sec.gov/litigation/admin/2009/ia-2883.pdf (cease-and-desist order and sanctions for misleading disclosures to board in violation of, *inter alia*, ICA § 15(c)); see also 15 U.S.C. §§ 80a-41, 80b-9. Congress surely did not tacitly incorporate into § 36(b) a private right of action for misconduct that is subject to express enforcement by other means.

It is thus unsurprising that courts have frequently recognized that § 36(b) is triggered only by the receipt of excessive compensation, and not by events that occur during negotiations. *Gartenberg*, 694 F.2d at 928; *Migdal*, 248 F.3d at 328-29 (Wilkinson, C.J.) ("Section 36(b) is limited to cases where there was excessive compensation."); see also *Krantz* v. *Prudential Invs. Fund Mgmt. LLC*, 305 F.3d 140, 144 n.2 (3d Cir. 2002) ("By definition, a violation of Section 36(b) encompasses excessive payments to the fund's advisers."); *Bellikoff* v. *Eaton Vance Corp.*, 481 F.3d 110, 118 (2d Cir. 2007) ("[O]ne must allege excessive fees, rather than fees that might simply be described as 'improper.'").

2. That is not to say that an adviser or board member's misconduct during the fee-approval process is irrelevant. Section 36(b)(2) insists that board approval "shall" be given such consideration as is "appropriate under all the circumstances." 15 U.S.C. § 80a-35(b)(2). But that inquiry is explicitly tied to fees. Judicial inquiry into whether a board's deliberations were "substance" or "formality" "would not be controlling in determining whether or not the fee encompassed a breach of duty." H.R. Rep. No. 1382, *supra*, at 37. Thus, an adviser's failure to make required disclosures or the board's failure to engage in substantive review would surely constitute a "circumstanc[e]" influencing the degree of judicial deference to board approval. But that lessened deference does not relieve a plaintiff's fundamental burden to show that a fee is so disproportionate that it could not have been the product of arm's-length negotiation. Process failures that do not culminate in "disproportionate" fees are not actionable. See *Gartenberg*, 694 F.2d at 928; *Migdal*, 248 F.3d at 329 (Wilkinson, C.J.). Otherwise, every conceivable alleged defect in negotiations would necessitate a

trial. Judicial micromanagement of negotiations is incompatible with Congress's concern that judges not "substitute [their] judgment for that of the [board]," so long as "the deliberations of the directors were a matter of substance" rather than "a mere formality." S. Rep. No. 184, *supra*, at 5, 15; see H.R. Rep. No. 1382, *supra*, at 37.

3. Petitioners claim to derive their fair-process test from the common law. But as noted above, § 36(b) does not create a private right of action to enforce *any* common-law "fiduciary duty" against the adviser. Nor does it simply replicate the specific law of trusts. It creates a strictly limited fiduciary duty "with respect to the receipt of compensation," one that provides only for actual damages caused by disproportionate fees. *Green* v. *Fund Asset Mgmt., L.P.*, 286 F.3d 682, 685 (3d Cir. 2002) (Section 36(b) "was intended to provide a very specific, narrow federal remedy that is more limited than the common law doctrines."); *Green* v. *Nuveen Advisory Corp.*, 295 F.3d 738, 743 (7th Cir. 2002) ("Congress enacted § 36(b) to provide a narrow federal remedy that is significantly more circumscribed than common law fiduciary duty doctrines." (citation omitted)).

The only case that lends support to petitioners' "fair process" standard is the Eighth Circuit's recent decision in *Gallus* v. *Ameriprise Financial, Inc.*, 561 F.3d 816 (8th Cir. 2009). The fact that the only decision supporting petitioners' view comes nearly three decades after the statute's enactment—and in one of the dozen cases simultaneously initiated, see p. 8 n.2, *supra*—is telling in itself. In any event, the Eighth Circuit's *Gallus* decision fails to analyze how that standard is consistent with § 36(b)'s text or the ICA's structure. See *Gallus*, 561 F.3d at 822-23. And the mutual fund adviser in *Gallus* has now filed a petition for a writ of certiorari in this

Court. See *Ameriprise Fin., Inc.* v. *Gallus*, No. 09-163 (petition filed Aug. 6, 2009).

## II. PETITIONERS' PROPOSED TWO-PART STANDARD WOULD IMPOSE EXTRAORDINARY BURDENS ON INVESTMENT ADVISERS WITHOUT COMMENSURATE BENEFITS TO INVESTORS

Petitioners' proposed standard of "fair and reasonable" review of both fees and process would injure the very shareholders whose interests they claim to champion. The standard would effectively foreclose the ability to dispose of cases on the pleadings or at summary judgment, and would compel judges to second-guess both rates and negotiations. The ostensible benefits from such judicial scrutiny are measurable for shareholders in grains off a penny, but they come at the cost of substantial resources devoted to expansive litigation.

### A. Petitioners' Proposed Standard Dooms Any Fund to Trial

Petitioners' two-part standard would entitle a shareholder to a trial on any claim that fees were "too high" or the process somehow "unfair."

Petitioners' "fair fees" prong would almost always require a trial because it would be next to impossible to prove on summary judgment that fees are "fair" or "reasonable." Indeed, petitioners provide no content to their fairness standard. Any plaintiff or retained expert could quibble about costs, cost-allocation, equivalent services, benefits, economies of scale, and disclosures, as they might impact fees. Any shareholder could expose those issues to judicial review, even if fund boards have addressed them, as occurred here. The hindsight assertion that they should have been resolved differently will always warrant review.

Similarly, petitioners' "fair process" prong would provoke a trial in nearly every case. Any perceived imperfection would suffice to trigger judicial review. In this case, for example, petitioners were unable to point to any *actual* failures of disclosure by Harris. Instead, petitioners claimed flaws in Harris's *method* of presenting certain information; their expert said he would have presented it differently. Petitioners then labeled Harris's methodology "false and misleading." J.A. 321-22, 329-30, 333. Petitioners' view of § 36(b) would make any similar issue ripe for judicial reassessment.

The risks are obvious. No matter how an adviser presents information on any topic conceivably relevant to fees, a plaintiff could always propose either a different method or nitpick about how the information was used. See, *e.g., Krinsk* v. *Fund Asset Mgmt., Inc.*, 875 F.2d 404, 409 (2d Cir. 1989) (district court did not err in refusing to measure performance on "risk-adjusted basis" because neither the SEC nor the industry had adopted that basis). Any claim that another approach was "better," or that independent directors should have applied the data differently in negotiations, would raise a disputed issue of fact. That consigns every mutual fund to a trial on a plaintiff's lawyer's whim.

This case illustrates the problem. Petitioners catalogued a litany of "issues" about the negotiations and the negotiators. Among other things, their shotgun approach claimed that social and business relations between trustees poisoned negotiations and that the board was dominated by a single member, who was "interested" based on compensation earned years before. But the district court's review of the undisputed record showed those allegations up as calumny. It concluded that the petitioners did not raise a triable issue of fact either to support their allegations or to suggest that they contributed an adverse influence on the process. Pet. App. 31a-33a. The standard petitioners articulate now, however, would convert the ability to raise such issues to a right to put any investment adviser through a trial. That would force courts into an inappropriate role, with no anchor in the statutory text.

### B. The Costs Of Petitioners' Proposed Standard Outweigh Its Slight Benefits

Petitioners' self-proclaimed role as investor champions ignores the cost their standard would impose.

Litigation is enormously expensive. Taking a suit from discovery through trial can easily cost tens of millions of dollars in attorneys' fees. The monetary cost is multiplied by the human costs, as the adviser, its officers, portfolio managers and fund board members produce documents, submit to depositions, and are distracted from their tasks. And the effective attack on board integrity that a fee suit represents inevitably raises a further impediment to attracting and retaining qualified board members. See generally *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 740 (1975) ("The very pendency of the lawsuit may frustrate or delay normal business activity of the defendant which is totally unrelated to the lawsuit.").

The real advantages to petitioners' standard are the benefits that accrue to lawyers. Because no individual shareholder could justify the cost of litigating fee and process "fairness" for the tiny, speculative personal benefit that might result, such claims, like securities class actions, pose "a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general," such that even frivolous cases may carry a high settlement value. *Blue Chip Stamps*, 421 U.S. at 739; see also *Amron* v. *Morgan Stanley Inv. Advisers, Inc.*, 464 F.3d 338, 346 (2d Cir. 2006) (declining "to permit" a § 36(b) "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 settlement value'" (quoting *Dura Pharms., Inc.* v. *Broudo*, 544 U.S. 336, 347 (2005), and *Blue Chip Stamps*, 421 U.S. at 741)).

## III. THE COURTS BELOW CORRECTLY CONCLUDED THAT HARRIS DID NOT BREACH ITS FIDUCIARY DUTY "WITH RESPECT TO THE RECEIPT OF COMPENSATION"

The lower courts in this case correctly held that Harris did not breach its § 36(b) fiduciary duty. The district court applied the *Gartenberg* standard. The Seventh Circuit "disapproved" *Gartenberg's* approach, but did not disturb the district court's key factual determinations. This Court should reject petitioners' proposed new standard and affirm the judgment.

### A. The District Court Appropriately Applied *Gartenberg* To The Undisputed Facts

The district court applied the *Gartenberg* standard to the undisputed facts and concluded that Harris's fees were not "so disproportionately large that [they bore] no reasonable relationship to the services rendered." Pet. App. 35a (quoting 694 F.2d at 928). In urging otherwise, petitioners rely almost exclusively on the fees Harris charged its non-mutual fund clients. The district court found the comparison factually inapt because the undisputed record established that the "services Harris provided to institutional clients varied, but in all events *were more limited* than those they provided to the Funds." *Id.* at 16a (emphasis added); pp. 39-44, *supra*. Indeed, even if the services were "indistinguishable," the fee differential was insufficient to establish disproportionality. "[T]he amounts paid by different parties establish a range of prices that investors were willing to pay." Pet. App. 30a. "Harris's fees fell within [that] range." *Ibid.*

The *Gartenberg* "factors" all weigh against petitioners. "[T]he services rendered by [Harris]" were "of the highest quality." *Gartenberg,* 694 F.2d at 930. Indeed, while investors in *Gartenberg* received slightly "better-than-average return[s]," *id.* at 926, 930, the Oakmark Funds returned best-in-class performance during the relevant period, including results that were multiples of benchmark indices, pp. 9-10, *supra*. Petitioners "do not dispute that Harris's fees were comparable to those charged by other similar funds," Pet. App. 30a, another factor considered by *Gartenberg*, 694 F.2d at 927, 929.

The district court also recognized that the Funds' fee negotiation process was robust. The court had "no reason to discount the notion that the shareholders' interests were represented at the negotiating table by a group of people who were capable of giving those interests primacy." Pet. App. 31a. Harris's disclosures to the trustees were extensive, and greater than what would have been available to the prototypical arm's-length negotiator. Harris described its services, fees, and profits attributable to both the mutual funds and its institutional accounts. J.A. 146, 152-81. As in *Gartenberg*, the evidence demonstrated that "the trustees were aware of or could obtain the essential facts needed to negotiate a reasonable fee" and that the "non-affiliated Fund trustees * * * had considered extensive relevant information before [approving the fee]." 694 F.2d at 933; see Pet. App. 16a. As the district court emphasized, the bargaining process need not result in the "best possible arrangement"; it need only produce a result that, on its face, could be the product of good-faith, arm's-length bargaining. Pet. App. 31a. The fees that Harris charged to the Funds met this standard and summary judgment was therefore appropriate. The court systematically and correctly rejected petitioners' myriad claims of process imperfections, finding they were either unsupported or had no effect on the board's conscientious execution of its fiduciary duty. *Id.* at 24a-26a.

### B. The Court of Appeals Did Not Disturb The Factual Conclusions Of The District Court

The Seventh Circuit did not disturb the factual analysis of the district court. Like the district court, it recognized the lack of comparability with the services provided to the Funds' institutional clients. Pet. App. 13a. It also recognized that the fees Harris charged the Funds were comparable to those that "other funds of similar size and investment goals pay their advisers," "in both levels and breakpoints." *Id.* at 6a. Both courts found the trustee-review process to be robust, triggering substantial deference under § 36(b)(2). The district court had "no reason to discount the notion that the shareholders' interests were represented at the negotiating table by a group of people who were capable of giving their interests primacy." *Id.* at 31a. The Seventh Circuit found no evidence that Harris "pulled the wool over the eyes of the disinterested trustees or otherwise hindered their ability to negotiate a favorable price for advisory services." *Id.* at 14a.

While the Seventh Circuit disapproved of the *Gartenberg* approach, it did not alter the district court's legal or factual analysis. *Gartenberg*'s focus on fees that are "so disproportionate" that they could not have resulted from arm's-length bargaining, 694 F.2d at 928, is akin to the Seventh Circuit's discussion of fees that are "so unusual" that they raise an inference of deceit. Pet. App. 9a. Although the Seventh Circuit used different language than the *Gartenberg* court to articulate the standard it applied, it looked to the same set of facts examined by the district court—the comparability of fees charged to similar mutual funds, the inapt comparisons to the fees charged to non-mutual fund clients, the robust trustee review and negotiation, and the lack of deceit or trickery on the part of Harris—in reaching the conclusion that Harris's fees did not violate § 36(b). Indeed, *Gartenberg* and the Seventh Circuit's approach "lead to the same place." *In re Mut. Funds Inv. Litig.*, 590 F. Supp. 2d 741, 760 (D. Md. 2008). On the same undisputed facts, both the district court, applying *Gartenberg*, and the Seventh Circuit, applying its similar standard, concluded that Harris's fees were neither "so disproportionate" nor "so unusual" to support a conclusion of fiduciary breach.

There is no reason for this Court to revisit those fact-intensive conclusions or to remand for the court of appeals to conduct a redundant exercise. It is the "settled practice" of this Court to accept "factual determinations in which the district court and court of appeals have concurred." *Branti* v. *Finkel*, 445 U.S. 507, 512 n.6 (1980). This Court should not upset "concurrent findings of fact by two courts below in the absence of a very obvious and exceptional showing of error." *Exxon Co., U.S.A.* v. *Sofec, Inc.*, 517 U.S. 830, 841 (1996). None has been shown here.

## CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals for the Seventh Circuit should be affirmed.

Respectfully submitted.

JOHN D. DONOVAN, JR.
*Counsel of Record*
ROBERT A. SKINNER
BENJAMIN HALASZ
BRIAN BLAIS
ROPES & GRAY LLP
One International Place
Boston, MA 02110-2624
(617) 951-7000

JEFFREY A. LAMKEN
BAKER BOTTS L.L.P.
1299 Pennsylvania Ave., NW
Washington, D.C. 20004-2400
(202) 639-7700

AARON M. STREETT
BAKER BOTTS L.L.P.
910 Louisiana Street
Houston, TX 77002
(713) 229-1234

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## RELEVANT STATUTORY PROVISIONS

Section 2 of the Investment Company Act of 1940, 15 U.S.C. § 80a-1 *et seq.*, provides in relevant part as follows:

**§ 80a-2. Definitions; applicability; rulemaking considerations**

**(a) Definitions**

When used in this subchapter, unless the context otherwise requires—

* * *

(19) "Interested person" of another person means—

(A) when used with respect to an investment company—

(i) any affiliated person of such company,

(ii) any member of the immediate family of any natural person who is an affiliated person of such company,

(iii) any interested person of any investment adviser of or principal underwriter for such company,

(iv) any person or partner or employee of any person who at anytime since the beginning of the last two completed fiscal years of such company has acted as legal counsel for such company,

(v) any person or any affiliated person of a person (other than a registered investment company) that, at any time during the 6-month period preceding the date of the determination of whether that person or affiliated person is an interested person, has executed any portfolio transactions for, engaged in any principal transactions with, or distributed shares for—

(I) the investment company;

(II) any other investment company having the same investment adviser as such investment company or holding itself out to investors as a related company for purposes of investment or investor services; or

(III) any account over which the investment company's investment adviser has brokerage placement discretion,

(vi) any person or any affiliated person of a person (other than a registered investment company) that, at any time during the 6-month period preceding the date of the determination of whether that person or affiliated person is an interested person, has loaned money or other property to—

(I) the investment company;

(II) any other investment company having the same investment adviser as such investment company or holding itself out to investors as a related company for purposes of investment or investor services; or

(III) any account for which the investment company's investment adviser has borrowing authority,[1]

(vii) any natural person whom the Commission by order shall have determined to be an interested person by reason of having had, at any time since the beginning of the last two completed fiscal years of such company, a material business or professional relationship with such company or with the principal executive officer of such company or with any other investment company having the same

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[1] So in original. Probably should be followed by the word "and".

investment adviser or principal underwriter or with the principal executive officer of such other investment company: *Provided*, That no person shall be deemed to be an interested person of an investment company solely by reason of (aa) his being a member of its board of directors or advisory board or an owner of its securities, or (bb) his membership in the immediate family of any person specified in clause (aa) of this proviso; and

(B) when used with respect to an investment adviser of or principal underwriter for any investment company—

(i) any affiliated person of such investment adviser or principal underwriter,

(ii) any member of the immediate family of any natural person who is an affiliated person of such investment adviser or principal underwriter,

(iii) any person who knowingly has any direct or indirect beneficial interest in, or who is designated as trustee, executor, or guardian of any legal interest in, any security issued either by such investment adviser of principal underwriter or by a controlling person or such investment adviser or principal underwriter,

(iv) any person or partner or employee of any person who at any time since the beginning of the last two completed fiscal years of such investment company has acted as legal counsel for such investment adviser or principal underwriter,

(v) any person or any affiliated person of a person (other than a registered investment company) that, at any time during the 6-month period preceding the date of the determination of whether that person or affiliated person is an interested person, has executed any portfolio transactions for, engaged in any principal transactions with, or distributed shares for—

(I) any investment company for which the investment adviser or principal underwriter serves as such;

(II) any investment company holding itself out to investors, for purposes of investment or investor services, as a company related to any investment company for which the investment adviser or principal underwriter serves as such; or

(III) any account over which the investment adviser has brokerage placement discretion,

(vi) any person or any affiliated person of a person (other than a registered investment company) that, at any time during the 6-month period preceding the date of the determination of whether that person or affiliated person is an interested person, has loaned money or other property to—

(I) any investment company for which the investment adviser or principal underwriter serves as such;

(II) any investment company holding itself out to investors, for purposes of investment or investor services, as a company related to any investment company for which the investment adviser or principal underwriter serves as such; or

(III) any account for which the investment adviser has borrowing authority,[2]

(vii) any natural person whom the Commission by order shall have determined to be an interested person by reason of having had at any time since

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[2] So in original. Probably should be followed by the word "and".

the beginning of the last two completed fiscal years of such investment company a material business or professional relationship with such investment adviser or principal underwriter or with the principal executive officer or any controlling person of such investment adviser or principal underwriter.

For the purposes of this paragraph (19), "member of the immediate family" means any parent, spouse of a parent, child, spouse of a child, spouse, brother, or sister, and includes step and adoptive relationships. The Commission may modify or revoke any order issued under clause (vi) of subparagraph (A) or (B) of this paragraph whenever it finds that such order is no longer consistent with the facts. No order issued pursuant to clause (vi) of subparagraph (A) or (B) of this paragraph shall become effective until at least sixty days after the entry thereof, and no such order shall affect the status of any person for the purposes of this subchapter or for any other purpose for any period prior to the effective date of such order.

* * *

Section 10 of the Investment Company Act of 1940, 15 U.S.C. § 80a-1 *et seq.*, provides in relevant part as follows:

**§ 80a-10. Affiliations or interest of directors, officers, and employees**

**(a) Interested persons of company who may serve on board of directors**

No registered investment company shall have a board of directors more than 60 per centum of the members of which are persons who are interested persons of such registered company.

**(b) Employment and use of directors, officers, etc., as regular broker, principal underwriter, or investment banker**

No registered investment company shall—

(1) employ as regular broker any director, officer, or employee of such registered company, or any person of which any such director, officer, or employee is an affiliated person, unless a majority of the board of directors of such registered company shall be persons who are not such brokers or affiliated persons of any of such brokers;

(2) use as a principal underwriter of securities issued by it any director, officer, or employee of such registered company or any person of which any such director, officer, or employee is an interested person, unless a majority of the board of directors of such registered company shall be persons who are not such principal underwriters or interested persons of any of such principal underwriters; or

(3) have as director, officer, or employee any investment banker, or any affiliated person of an investment banker, unless a majority of the board of directors of such registered company shall be persons who are not investment bankers or affiliated persons of any invest-

ment banker. For the purposes of this paragraph, a person shall not be deemed an affiliated person of an investment banker solely by reason of the fact that he is an affiliated person of a company of the character described in section 80a-12(d)(3)(A) and (B) of this title.

**(c) Officers, directors, or employees of one bank or bank holding company as majority of board of directors of company; exceptions**

No registered investment company shall have a majority of its board of directors consisting of persons who are officers, directors, or employees of any one bank (together with its affiliates and subsidiaries) or any one bank holding company (together with its affiliates and subsidiaries) (as such terms are defined in section 1841 of title 12) or any one savings and loan holding company, together with its affiliates and subsidiaries (as such terms are defined in section 1467a of title 12), except that, if on March 15, 1940, any registered investment company had a majority of its directors consisting of persons who are directors, officers, or employees of any one bank, such company may continue to have the same percentage of its board of directors consisting of persons who are directors, officers, or employees of such bank.

**(d) Exception to limitation of number of interested persons who may serve on board of directors**

Notwithstanding subsections (a) and (b)(2) of this section, a registered investment company may have a board of directors all the members of which, except one, are interested persons of the investment adviser of such company, or are officers or employees of such company, if—

(1) such investment company is an open-end company;

(2) such investment adviser is registered under subchapter II of this chapter and is engaged principally in the business of rendering investment supervisory services as defined in subchapter II;

(3) no sales load is charged on securities issued by such investment company;

(4) any premium over net asset value charged by such company upon the issuance of any such security, plus any discount from net asset value charged on redemption thereof, shall not in the aggregate exceed 2 per centum;

(5) no sales or promotion expenses are incurred by such registered company; but expenses incurred in complying with laws regulating the issue or sale of securities shall not be deemed sales or promotion expenses;

(6) such investment adviser is the only investment adviser to such investment company, and such investment adviser does not receive a management fee exceeding 1 per centum per annum of the value of such company's net assets averaged over the year or taken as of a definite date or dates within the year;

(7) all executive salaries and executive expenses and office rent of such investment company are paid by such investment adviser; and

(8) such investment company has only one class of securities outstanding, each unit of which has equal voting rights with every other unit.

**(e) Death, disqualification, or resignation of directors as suspension of limitation provisions**

If by reason of the death, disqualification, or bona fide resignation of any director or directors, the requirements of the foregoing provisions of this section or of section 80a-15(f)(1) of this title in respect of directors shall not be met by a registered investment company, the operation of such provision shall be suspended as to such registered company—

(1) for a period of thirty days if the vacancy or vacancies may be filled by action of the board of directors;

(2) for a period of sixty days if a vote of stockholders is required to fill the vacancy or vacancies; or

(3) for such longer period as the Commission may prescribe, by rules and regulations upon its own motion or by order upon application, as not inconsistent with the protection of investors.

**(f) Officer, director, etc., of company acting as principal underwriter of security acquired by company**

No registered investment company shall knowingly purchase or otherwise acquire, during the existence of any underwriting or selling syndicate, any security (except a security of which such company is the issuer) a principal underwriter of which is an officer, director, member of an advisory board, investment adviser, or employee of such registered company, or is a person (other than a company of the character described in section 80a-12(d)(3)(A) and (B) of this title) of which any such officer, director, member of an advisory board, investment adviser, or employee is an affiliated person, unless in acquiring such security such registered company is itself acting as a principal underwriter for the issuer. The Commission, by rules and regulations upon its own motion or by order upon application, may conditionally or unconditionally exempt any transaction or classes of transactions from any of the provisions of this subsection, if and to the extent that such exemption is consistent with the protection of investors.

**(g) Advisory boards; restrictions on membership**

In the case of a registered investment company which has an advisory board, such board, as a distinct entity, shall be subject to the same restrictions as to its membership as are imposed upon a board of directors by this section.

**(h) Application of section to unincorporated registered management companies**

In the case of a registered management company which is an unincorporated company not having a board of directors, the provisions of this section shall apply as follows:

(1) the provisions of subsection (a) of this section, as modified by subsection (e) of this section, shall apply to the board of directors of the depositor of such company;

(2) the provisions of subsections (b) and (c) of this section, as modified by subsection (e) of this section, shall apply to the board of directors of the depositor and of every investment adviser of such company; and

(3) the provisions of subsection (f) of this section shall apply to purchases and other acquisitions for the account of such company of securities a principal underwriter of which is the depositor or an investment adviser of such company, or an affiliated person of such depositor or investment adviser.

* * *

Section 15 of the Investment Company Act of 1940, 15 U.S.C. § 80a-1 *et seq.*, provides in relevant part as follows:

**§ 80a-15. Contracts of advisers and underwriters**

**(a) Written contract to serve or act as investment adviser; contents**

It shall be unlawful for any person to serve or act as investment adviser of a registered investment company, except pursuant to a written contract, which contract, whether with such registered company or with an investment adviser of such registered company, has been approved by the vote of a majority of the outstanding voting securities of such registered company, and—

(1) precisely describes all compensation to be paid thereunder;

(2) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company;

(3) provides, in substance, that it may be terminated at any time, without the payment of any penalty, by the board of directors of such registered company or by vote of a majority of the outstanding voting securities of such company on not more than sixty days' written notice to the investment adviser; and

(4) provides, in substance, for its automatic termination in the event of its assignment.

**(b) Written contract with company for sale by principal underwriter of security of which company is issuer; contents**

It shall be unlawful for any principal underwriter for a registered open-end company to offer for sale, sell, or deliver after sale any security of which such company is the issuer, except pursuant to a written contract with such company, which contract—

(1) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company; and

(2) provides, in substance, for its automatic termination in the event of its assignment.

**(c) Approval of contract to undertake service as investment adviser or principal underwriter by majority of noninterested directors**

In addition to the requirements of subsections (a) and (b) of this section, it shall be unlawful for any registered investment company having a board of directors to enter into, renew, or perform any contract or agreement, written or oral, whereby a person undertakes regularly to serve or act as investment adviser of or principal underwriter for such company, unless the terms of such contract or agreement and any renewal thereof have been approved by the vote of a majority of directors, who are not parties to such contract or agreement or interested persons of any such party, cast in person at a meeting called for the purpose of voting on such approval. It shall be the duty of the directors of a registered investment company to request and evaluate, and the duty of an investment adviser to such company to furnish, such information as may reasonably be necessary to evaluate the terms of any contract whereby a person undertakes regularly to serve or act as investment adviser of such company. It shall be unlawful for the directors of a registered investment company, in connection with their evaluation of the terms of any contract whereby a person undertakes regularly to serve or act as investment adviser of such company, to take into account the purchase price or other consideration any person may have paid in connection with a transaction of the type referred to in paragraph (1), (3), or (4) of subsection (f) of this section.

**(d) Equivalent of vote of majority of outstanding voting securities in case of common-law trust**

In the case of a common-law trust of the character described in section 80a-16(c) of this title, either written approval by holders of a majority of the outstanding shares of beneficial interest or the vote of a majority of such outstanding shares cast in person or by proxy at a meeting called for the purpose shall for the purposes of this section be deemed the equivalent of the vote of a majority of the outstanding voting securities, and the provisions of paragraph (42) of section 80a-2(a) of this title as to a majority shall be applicable to the vote cast at such a meeting.

**(e) Exemption of advisory boards or members from provisions of this section**

Nothing contained in this section shall be deemed to require or contemplate any action by an advisory board of any registered company or by any of the members of such a board.

**(f) Receipt of benefits by investment adviser from sale of securities or other interest in such investment adviser resulting in assignment of investment advisory contract**

(1) An investment adviser, or a corporate trustee performing the functions of an investment adviser, of a registered investment company or an affiliated person of such investment adviser or corporate trustee may receive any amount or benefit in connection with a sale

of securities of, or a sale of any other interest in, such investment adviser or corporate trustee which results in an assignment of an investment advisory contract with such company or the change in control of or identity of such corporate trustee, if—

(A) for a period of three years after the time of such action, at least 75 per centum of the members of the board of directors of such registered company or such corporate trustee (or successor thereto, by reorganization or otherwise) are not (i) interested persons of the investment adviser of such company or such corporate trustee, or (ii) interested persons of the predecessor investment adviser or such corporate trustee; and

(B) there is not imposed an unfair burden on such company as a result of such transaction or any express or implied terms, conditions, or understandings applicable thereto.

(2)(A) For the purpose of paragraph (l)(A) of this subsection, interested persons of a corporate trustee shall be determined in accordance with section 80a-2(a)(19)(B) of this title: *Provided*, That no person shall be deemed to be an interested person of a corporate trustee solely by reason of (i) his being a member of its board of directors or advisory board or (ii) his membership in the immediate family of any person specified in clause (i) of this subparagraph.

(B) For the purpose of paragraph (1)(B) of this subsection, an unfair burden on a registered investment company includes any arrangement, during the two-year period after the date on which any such transaction occurs, whereby the investment adviser or corporate trustee or predecessor or successor investment advisers or corporate trustee or any interested person of any such adviser or any such corporate trustee receives or is entitled to receive any compensation directly or indirectly (i) from any person in connection with the purchase or sale of securities or other property to, from, or on behalf of such company, other than bona fide ordinary compensation as principal underwriter for such company, or (ii) from such company or its security holders for other than bona fide investment advisory or other services.

(3) If—

(A) an assignment of an investment advisory contract with a registered investment company results in a successor investment adviser to such company, or if there is a change in control of or identity of a corporate trustee of a registered investment company, and such adviser or trustee is then an investment adviser or corporate trustee with respect to other assets substantially greater in amount than the amount of assets of such company, or

(B) as a result of a merger of, or a sale of substantially all the assets by, a registered investment company with or to another registered investment company with assets substantially greater in amount, a transaction occurs which would be subject to paragraph (1)(A) of this subsection, such discrepancy in size of assets shall be considered by the Commission in determining whether or to what extent an application under section 80a-6(c) of this title for exemption from the provisions of paragraph (l)(A) of this subsection should be granted.

(4) Paragraph (l)(A) of this subsection shall not apply to a transaction in which a controlling block of outstanding voting securities of an investment adviser to a registered investment company or of a corporate trustee performing the functions of an investment adviser to a registered investment company is—

(A) distributed to the public and in which there is, in fact, no change in the identity of the persons who control such investment adviser or corporate trustee, or

(B) transferred to the investment adviser or the corporate trustee, or an affiliated person or persons of such investment adviser or corporate trustee, or is transferred from the investment adviser or corporate trustee to an affiliated person or persons of the investment adviser or corporate trustee: *Provided*, That (i) each transferee (other than such adviser or trustee) is a natural person and (ii) the transferees (other than such adviser or trustee) owned in the aggregate more than 25 per centum of such voting securities for a period of at least six months prior to such transfer.

* * *

Section 36 of the Investment Company Act of 1940, 15 U.S.C. § 80a-1 *et seq.*, provides in relevant part as follows:

**§ 80a-35. Breach of fiduciary duty**

**(a) Civil actions by Commission; jurisdiction; allegations; injunctive or other relief**

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

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

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

If such allegations are established, the court may enjoin such persons from acting in any or all such capacities either permanently or temporarily and award such injunctive or other relief against such person as may be reasonable and appropriate in the circumstances, having due regard to the protection of investors and to the effectuation of the policies declared in section 80a-1(b) of this title.

**(b) Compensation or payments as basis of fiduciary duty; civil actions by Commission or security holder; burden of proof; judicial consideration of director or shareholder approval; persons liable; extent of**

**liability; exempted transactions; jurisdiction; finding restriction**

For the purposes of this subsection, the investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser. An action may be brought under this subsection by the Commission, or by a security holder of such registered investment company on behalf of such company, against such investment adviser, or any affiliated person of such investment adviser, or any other person enumerated in subsection (a) of this section who has a fiduciary duty concerning such compensation or payments, for breach of fiduciary duty in respect of such compensation or payments paid by such registered investment company or by the security holders thereof to such investment adviser or person. With respect to any such action the following provisions shall apply:

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

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

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

(4) This subsection shall not apply to compensation or payments made in connection with transactions subject to section 80a-17 of this title, or rules, regulations, or orders thereunder, or to sales loads for the acquisition of any security issued by a registered investment company.

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

(6) No finding by a court with respect to a breach of fiduciary duty under this subsection shall be made a basis (A) for a finding of a violation of this subchapter for the purposes of sections 80a-9 and 80a-48 of this title, section 78o of this title, or section 80b-3 of this title, or (B) for an injunction to prohibit any person from serving in any of the capacities enumerated in subsection (a) of this section.

**(c) Corporate or other trustees performing functions of investment advisers**

For the purposes of subsections (a) and (b) of this section, the term "investment adviser" includes a corporate or other trustee performing the functions of an investment adviser.

* * *