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JUDICIAL DEFERENCE TO MUTUAL FUND BOARDS: LESSONS FROM POST-*JONES* EXCESSIVE FEE LITIGATION

Following on the Supreme Court's Jones *decision, the plaintiffs' bar filed a large wave of actions claiming that mutual funds paid excessive fees to their advisers. The authors analyze this litigation. They focus first on plaintiffs' challenges to the independence and qualifications of independent directors. They then turn to plaintiffs' claims that board processes for reviewing and approving fees were deficient. Although all of plaintiffs' claims have been rejected by the courts, the authors conclude that new fee litigation is "almost certain" and that recent decisions provide valuable insights into current best practices for fund directors.*

By Sean M. Murphy, Robert J. Liubicic, and Ayana Sumiyasu *

Mutual funds are a more than $21 trillion industry, a fact not lost on the plaintiffs' bar.[1] In 1970, Congress enacted Section 15(c) of the Investment Company Act (the "ICA"), the primary federal statute governing mutual funds, which set forth the role of independent directors of mutual funds in reviewing and approving investment advisory contracts and other contracts that establish the fees charged to fund shareholders. At the same time, Congress enacted Section 36(b) of the ICA, which established a fiduciary duty on the part of fund advisers with respect to their receipt of fees, and provided fund shareholders with a private right of action to assert claims for breaches of that duty.[2] Since 1970, the industry has contended with multiple waves of largely attorney-driven Section 36(b) suits based on evolving theories of liability.

In 2010, the Supreme Court held in *Jones v. Harris Associates L.P.* that, to establish liability under Section 36(b), a plaintiff must show that an investment adviser charged a fee "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."[3] In doing so, the Court held that a lower court must consider "all relevant circumstances," including the six-factor framework for assessing Section 36(b) claims set forth in the Second Circuit's 1982 decision in *Gartenberg v. Merrill Lynch Asset Management, Inc.*[4] The "*Gartenberg* factors," which

[1] Investment Company Institute, *2020 Investment Company Fact Book: A Review of Trends and Activities in the Investment Company Industry* (60th Ed.) at 31.

[2] Investment Company Act of 1940, § 36(b), 15 U.S.C.A. § 80a–35(b).

[3] *Jones v. Harris Assocs. L.P.*, 559 U.S. 335, 346 (2010).

[4] *Gartenberg v. Merrill Lynch Asset Mgmt., Inc.*, 694 F.2d 923 (2d Cir. 1982).

* *SEAN M. MURPHY is a partner in the New York office of Milbank LLP. ROBERT J. LIUBICIC is a partner and AYANA SUMIYASU is an associate in the Los Angeles office of the firm. Their e-mail addresses are smurphy@milbank.com, rliubicic@milbank.com, and asumiyasu@milbank.com.*

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