

# *JONES v. HARRIS ASSOCIATES:* SHAREHOLDER REQUIREMENTS FOR PROVING A MUTUAL FUND ADVISER'S BREACH OF FIDUCIARY DUTY

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## I. INTRODUCTION

Congress amended the Investment Company Act of 1940 (“ICA”) in 1970 to create a fiduciary duty among investment advisers with respect to compensation for services provided, and a private right of action for security holders to enforce that duty.<sup>1</sup> Thirty-four years later, security holders of several mutual funds brought an action against the funds’ investment adviser, alleging that the adviser’s compensation was excessive in violation Section 36(b) of the ICA.<sup>2</sup> The Seventh Circuit departed from standard used in other circuits, and emphasized only the candor of the adviser to the board when determining whether or not the adviser’s compensation was lawful under the ICA.<sup>3</sup> The court based its decision on the competition of the mutual fund market and the sophistication of individual investors to keep an adviser’s compensation at an efficient level,<sup>4</sup> while the precedent stated that investment advisers do not in reality compete with each other for advisory contracts with mutual funds.<sup>5</sup> In light of the circuit split,<sup>6</sup> the Supreme Court granted certiorari to consider

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1. *Gartenberg v. Merrill Lynch Asset Mgmt., Inc.*, 694 F.2d 923, 927 \*2d Cir. 1982); 15 U.S.C.A. § 80a–35(b) (West 2003 & Supp. 2007).

2. *Jones v. Harris Assocs.*, 2007 WL 627640, at \*2 (N.D. Ill. 2007) (*Jones I*), *aff’d*, 527 F.3d 627 (7th Cir. 2008) *reh’g en banc denied*, 537 F.3d 728 (7th Cir. 2008), *cert. granted*, 129 S. Ct. 1579 (2009).

3. *Jones v. Harris Assocs.*, 527 F.3d 627, 632 (7th Cir. 2008) (*Jones II*).

4. *Id.*

5. *Gartenberg*, 694 F.2d at 929.

6. *See Jones v. Harris Assocs.*, 537 F.3d 728, 732 (7th Cir. 2008) (*Jones III*) (Posner, J., dissenting) (indicating the decision created a circuit split).

which standard should be used to determine whether a mutual fund's fees are excessive under § 36(b).

## II. FACTS

Harris Associates (“Harris”) is an investment advisement company responsible for managing a group of mutual funds collectively known as the Oakmark complex of funds.<sup>7</sup> Harris’s compensation for managing the funds investment adviser was determined annually by Oakmark’s board of trustees.<sup>8</sup> In setting Harris’ compensation, the board examined “the fund’s performance, the services Harris provided,” the fees Harris charged other clients, the fees other investment advisers charged to manage similar funds.<sup>9</sup> The board calculated the fees for all three funds as one percent or less of the funds’ total assets at the end of the preceding month, and included breakpoints, or a fee reduction when assets grew above a certain amount.<sup>10</sup> For example, the eponymous fund of the complex agreed to pay Harris “1% of the first \$2 billion of the [f]und’s assets, 0.9% for the next \$1 billion, 0.8% for the next \$2 billion, and then 0.75% for assets in excess of \$5 billion.”<sup>11</sup> The other two funds at issue had similar fee schedules.<sup>12</sup> These fees were “roughly the same (in both level and breakpoints) as those that other funds of similar size and investment goals pay their advisers.”<sup>13</sup> Harris also provided information for the fees that they charged “institutional clients”—clients not affiliated with a mutual fund—which included fee percentages and breakpoints with significantly lower amounts,<sup>14</sup> sometimes even half of the fees they charged mutual funds.<sup>15</sup>

The board of Oakmark which approved the compensation scheme was comprised of ten members, several of whom maintained business relationships with Harris.<sup>16</sup> Victor Morgenstern previously worked for

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7. *Jones II*, 527 F.3d at 629; *Jones I*, 2007 WL 627640, at \*1.

8. *Jones I*, 2007 WL 627640, at \*1.

9. *Id.*

10. *Id.*

11. *Id.*

12. *See id.* at \*2. (delineating exact percentages and breakpoints for the other two funds, Global and Equity. ).

13. *Jones v. Harris Assocs.*, 527 F.3d 627, 631 (7th Cir. 2008) (*Jones II*).

14. *Jones I*, 2007 WL 627640, at \*1 (“For institutional clients with investment strategies similar to Oakmark’s the percentages ranged from 0.075% to 0.35%, with breakpoints ranging from \$15 million to \$500 million.”).

15. *Jones v. Harris Assocs.*, 537 F.3d 728, 732 (7th Cir. 2008) (Posner, J., dissenting) (*Jones III*).

16. *Jones I*, 2007 WL 627640, at \*1.

Harris and retired in 2001; John Raitt left the board to become CEO and President of Harris in 2003; and Peter Voss was CEO and President of Harris's parent company.<sup>17</sup> Morgenstern maintained social and business relationships with employees at Harris, and the other board members also had personal, social, and non-fund business relationships with Harris employees.<sup>18</sup> These relationships raised an issue of whether the board had set Harris' compensation in an truly arm's-length transaction.<sup>19</sup>

The plaintiff shareholders brought derivative suits on behalf of the mutual funds in August of 2004, claiming that Harris had violated § 36(b) of the ICA.<sup>20</sup> The shareholders claimed that Harris breached its fiduciary duty under § 36(b) by (1) charging the Oakmark funds at a substantially higher rate than institutional clients; (2) failing to recognize cost-savings from economies of scale in determining the fee schedule; and (3) violating the ICA requirement of arm's-length dealings with the Oakmark board.<sup>21</sup> The District Court for the Northern District of Illinois applied the *Gartenberg* test and concluded that the fees were not excessive because they reflected the rates of other mutual funds.<sup>22</sup> In granting the defendant's motion for summary judgment, the district court also concluded that most of the violations asserted by the plaintiffs were not within the scope of the private right of action created for shareholders under § 36(b) because the defendant's actions did not constitute an actual conflict of interest resulting in harm to the shareholders.<sup>23</sup> The plaintiffs appealed from this grant of summary judgment.<sup>24</sup>

### III. LEGAL BACKGROUND

Congress long ago concluded that mutual funds and other investment companies required special regulation based on the "potential for abuse inherent in the structure of investment companies."<sup>25</sup> This belief led Congress to pass the Investment

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17. *Id.* at \*2.

18. *Id.*

19. *Id.*

20. *Id.*

21. *Id.* at \*9-13.

22. *Jones v. Harris Assocs.*, 527 F.3d 627, 631 (7th Cir. 2008) (*Jones II*).

23. *Jones I*, 2007 WL 627640, at \*5.

24. *Jones II*, 527 F.3d at 629.

25. *Burks v. Lasker*, 441 U.S. 471, 480 (1979), *quoted in* Brief of the United States as Amicus Curiae Supporting Petitioner at 2, *Jones v. Harris Assocs.*, No. 08-586 (U.S. June 15, 2009).

Company Act of 1940, which contained multiple provisions designed to guard against potential conflicts of interest common to investment companies.<sup>26</sup> Over time, however, significant growth in the mutual fund market rendered the ICA ineffective.<sup>27</sup> Congress amended the ICA in 1970 to include Securities and Exchange Commission proposals, which cited studies that illuminated the existing Act's deficiencies.<sup>28</sup> One of the ICA amendments was § 36(b), which creates a private right of action to enforce a new fiduciary duty of mutual fund advisers when negotiating their fees:

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 paid by such registered investment company . . . [and a]n action may be brought under this subsection by the Commission, or by a security holder against such adviser . . . 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.

Several circuits have looked to the legislative history and textual clues of the ICA in an effort to determine the meaning of fiduciary duty.<sup>30</sup> Although no consistent definition has emerged, in *Green v. Fund Asset Management*, the Third Circuit Court of Appeals examined the structure of the fiduciary duty created by § 36(b) and concluded that it was more narrow than the common law doctrine of fiduciary duty for two reasons.<sup>31</sup> First, the ICA limits damages claimed from the breach of fiduciary duty to the actual damages paid to the recipient and limits recovery to one year prior to the initiation of the suit.<sup>32</sup> Second, the plaintiff has the burden to prove breach, a significant departure from the common law requirement placing the burden on the fiduciary to justify its conduct.<sup>33</sup> These conditions ensured that the federal cause of action created by § 36(b) would be

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26. *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 536 (1984).

27. *Id.* at 537.

28. *Id.* at 537–538.

29. 15 U.S.C.A. § 80a–35(b) (West 2003).

30. See *Green v. Nuveen Advisory Corp.*, 295 F.3d 738, 742 (7th Cir. 2002) (stating that § 36(b) of the ICA was not meant to revolutionize the industry practice, but provide a narrow federal remedy); *Gartenberg v. Merrill Lynch Asset Mgmt., Inc.*, 694 F.2d 923, 928 (2d Cir. 1982) (examining failed legislative bills, the Senate Report, and the House Committee Report).

31. *Green v. Fund Asset Mgmt.*, 286 F.3d 682, 685 (3d Cir. 2002).

32. *Id.*

33. *Id.*

more narrow.<sup>34</sup>

In *Gartenberg v. Merrill Lynch Asset Management*, the Second Circuit outlined what would become the generally-accepted standard for determining whether an investment adviser had violated its fiduciary duty under § 36(b).<sup>35</sup> This standard became known as the *Gartenberg* test, which considers:

[W]hether the fee schedule represents a charge within the range of what would have been negotiated at arm's-length in light of all the surrounding circumstances. . . . To be guilty of a violation of § 36(b), therefore, 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.<sup>36</sup>

*Gartenberg* set out a number of non-exclusive factors to be considered when examining whether the fees were excessive: the similarity of fees to those charged at other mutual funds; the comparability of fees charged to institutional clients with similar services; the cost to the adviser to provide services to the fund; the nature and quality of the services, including the historical performance of the fund; the economies of scale the adviser gains as the fund's assets increase; the volume of orders from the investors that need to be processed; and the conduct, expertise, and level of information that trustees of the fund possessed.<sup>37</sup> After examining these and other factors, the court must determine if the fees fall "within the range" of fees possibly arrived at after arm's-length negotiations.<sup>38</sup>

#### IV. HOLDING

To determine whether Harris breached its fiduciary duty to the plaintiffs, the Seventh Circuit analyzed each of the claims filed under the ICA.<sup>39</sup> The court first determined that several ICA sections implicated by the plaintiff's claims were not applicable because the court found that "although § 36(b) creates a private right of action,

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34. *See id.* (discussing the limited damages, shifted burden of proof, as well as the Senate report that accompanied the act).

35. *Gartenberg*, 694 F.2d at 928.

36. *Id.*

37. *Jones v. Harris Assocs.*, 2007 WL 627640, at \*7 (N.D. Ill. 2007) (*Jones I*).

38. *Gartenberg*, 694 F.2d at 928.

39. *Jones v. Harris Assocs.*, 527 F.3d 627, 629 (7th Cir. 2008) (*Jones II*).

the other sections we have mentioned do not.”<sup>40</sup> The plaintiffs, on the other hand, wished to include these violations as evidence of the failure of the board to negotiate at arm’s-length and establish efficient fees.<sup>41</sup> The plaintiffs alleged that the fund violated the ICA by failing to ensure at least forty percent of the board members were disinterested in their relationships with the adviser.<sup>42</sup> The plaintiffs claimed that due to the fund’s failure to reveal the financial links between its trustees and adviser,<sup>43</sup> the adviser’s compensation was not controlled by a majority of disinterested trustees.<sup>44</sup> The Seventh Circuit made “short work” of these claims, concluding that none of the alleged violations had a private right of action attached to them and further that there had been no actual violation of the sections.<sup>45</sup> The court analyzed the status of Trustee Morgenstern and decided that although Morgenstern was an “interested” party, seven of the nine trustees were deemed “disinterested” parties—enough for a majority and above the required forty percent.<sup>46</sup> The court declared that although the “[p]laintiffs ask us to suppose that Morgenstern possessed some Svengali-like sway over the other trustees, so that his presence in the room was enough to spoil their decisions,” interested trustees retained the right to speak and discuss votes on the contract, and the board would have approved the compensation even without counting his vote.<sup>47</sup>

Next, the court turned to “the main event”—the plaintiffs § 36(b) claim that the adviser’s fees were excessive.<sup>48</sup> The Seventh Circuit, however, specifically disavowed the *Gartenberg* test.<sup>49</sup> The court declared that the only applicable standard was that “[a] fiduciary must make full disclosure and play no tricks [on the board of trustees] but is not subject to a cap on compensation.”<sup>50</sup> The court declared that the markets would establish the adviser’s compensation.<sup>51</sup> By presuming that the mutual fund markets are efficient, the court held that the

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40. *Id.*

41. Brief of Petitioners at 12–13, *Jones v. Harris Assocs.*, No. 08-586 (U.S. June 10, 2009).

42. 15 U.S.C.A. § 80a–10(a) (West 2003).

43. 15 U.S.C.A. § 80a–33(b).

44. 15 U.S.C.A. § 80a–15(c).

45. *Jones II*, 527 F.3d at 629.

46. *Id.* at 629–30.

47. *Id.* at 630.

48. *Id.*

49. *Id.* at 632.

50. *Id.*

51. *See id.* (“The trustees (and in the end investors, who vote with their feet and dollars), rather than a judge or jury, determine how much advisory services are worth.”)

only cause of action under § 36(b) is for a failure to make full disclosure.<sup>52</sup> The Seventh Circuit held that the term “fiduciary duty” invoked the law of trusts, which required “candor in negotiation, and honesty in performance” but allowed fiduciaries the ability to negotiate their compensation without judicial scrutiny.<sup>53</sup>

Given the large number of mutual funds, the court decided that competition sufficiently protected investors from excessive fees.<sup>54</sup> The evidence that Harris charged lower fees to institutional clients was dismissed based on the court’s observation that “[d]ifferent clients call for different commitments of time.”<sup>55</sup> Finally, because the plaintiffs never alleged that Harris deceived the funds’s board of trustees, the Seventh Circuit held that the compensation should stand and affirmed the district court’s decision.<sup>56</sup>

The case came up on appeal for a rehearing en banc, and when rehearing was denied Judge Posner dissented.<sup>57</sup> The dissent argued that the court erred in rejecting *Gartenberg*, and the majority analogized the circumstances of mutual fund compensation too closely to other industries that do not face the same conflicts of interest.<sup>58</sup>

## V. ANALYSIS

The Seventh Circuit’s departure from the *Gartenberg* standard is troubling. The *Gartenberg* standard has been an accepted part of American law for more than twenty years, and has been relied on by mutual fund companies, other circuits and Securities and Exchange Commission regulators. *Jones v. Harris* was the first decision to disapprove the *Gartenberg* standard; meanwhile, other circuits have made a “slew of positive citations” supporting *Gartenberg*.<sup>59</sup> The SEC also approved the factors detailed in *Gartenberg* by incorporating the factors into SEC regulations,<sup>60</sup> creating a history of reliance on this analysis in the mutual fund industry.

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52. *Id.*

53. *Id.* (citing RESTATEMENT (SECOND) OF TRUSTS § 242 cmt. f).

54. *Id.* at 634.

55. *Id.* at 634–35.

56. *Id.* at 635.

57. *Jones v. Harris Assocs.*, 537 F.3d 728, 730 (7th Cir. 2008) (Posner, J., dissenting) (*Jones III*).

58. *Id.* at 730–733.

59. *Id.* at 729.

60. Brief for the United States as Amicus Curiae Supporting Petitioners, *supra* note 25, at 23–24.

The Seventh Circuit's decision is that it rests on what Judge Posner called "an economic analysis that is ripe for reexamination."<sup>61</sup> *Jones v. Harris* stated that "just as plaintiffs are skeptical of *Gartenberg* because it relies too heavily on markets, we are skeptical about *Gartenberg* because it relies too little on markets."<sup>62</sup> The opinion further noted that the model of board approval that mutual funds use to determine adviser compensation is similar to that of large corporations, and that this model is not subject to judicial oversight in that context.<sup>63</sup> The court's decision ultimately put its faith in the presumed sophistication of individual investors to keep investment adviser fees competitive by shopping around for mutual funds with lower fees.<sup>64</sup> However, this analysis all relies on the court's presumption that the mutual fund market is efficient. This reasoning ignores a body of literature indicating that mutual funds boards' conflicts of interest defeat the boards' incentives to bargain for lower compensation.<sup>65</sup> By establishing a principle similar to the business judgment rule, the court ignored the fact that "although mutual funds have the trappings of typical corporations, their external management structure sets them apart."<sup>66</sup> Mutual fund boards are often composed of interested parties, semi-interested parties,<sup>67</sup> or advisers of other mutual funds, resulting in a truly "captive" board more interested in creating profits for the adviser than the fund.<sup>68</sup>

The new standard suggested by the Seventh Circuit seemingly contradicts the purpose of the statute. Section 36(b) of the ICA specifically provides that the board's approval "shall be given such consideration by the court as is deemed appropriate *under all the circumstances*."<sup>69</sup> This seems to contemplate a thorough test, such as *Gartenberg*, rather than the deferential standard outlined in *Jones v.*

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61. *Jones III*, 537 F.3d at 730 (Posner, J., dissenting).

62. *Jones v. Harris Assocs.*, 527 F.3d 627, 632 (7th Cir. 2008) (*Jones II*).

63. *Id.* at 632–33.

64. *Id.* at 634–35.

65. *Jones III*, 537 F.3d at 730 (Posner, J., dissenting).

66. Emily Johnson, Note, *The Fiduciary Duty in Mutual Fund Excessive Fee Cases: Ripe for Reexamination*, 59 DUKE L.J. 145, 151 (2009) (discussing the fact that the close nexus between investment advisers and the mutual fund board undermines the any incentive of the board to establish meaningful limits on the adviser).

67. A review of the relationships in this case set out in the district court opinion, *Jones v. Harris Assocs.*, 2007 WL 627640 at \*2 (N.D. Ill. 2007) (*Jones I*), shows that even the "uninterested" board members had close ties to Harris Assocs. through other members of the board or other business arrangements, so close as to make them probably all excessively sympathetic to the advisers they are bargaining with at "arm's length."

68. *Jones III*, 537 F.3d at 730–32 (comparing investment fund advisor compensation to executive compensation).

69. 15 U.S.C.A. § 80a-35(b)(2) (West 2003) (emphasis added).



*Harris*. However, under the Seventh Circuit's rule, the § 36(b) fiduciary duty would be so narrow that meeting it would require no more than compliance with other sections of the ICA, effectively rendering the section redundant.<sup>70</sup> This standard seems unlikely to be affirmed on appeal.

## VI. ARGUMENTS

### *Petitioners' Arguments*

The shareholders presented two arguments urging the Court to overturn the Seventh Circuit's decision. The first argument was that the "fiduciary duty" imposed on mutual fund investment advisers by § 36(b) is a two-prong requirement: an obligation to disclose "all material facts relating to" compensation and an obligation that the compensation they receive be fair and negotiated for "in an arm's-length transaction."<sup>71</sup> In the second argument the shareholders attack the Seventh Circuit's reliance on a competitive market to keep fees efficient. Specifically, they claim mutual funds do not operate in a competitive environment and the ICA was designed with this in mind.<sup>72</sup>

First, the shareholders argued that the fiduciary duty provided for in § 36(b) requires investment advisers to do two things: disclose information about their compensation and negotiate for their compensation in an arm's length transaction. This standard is an expansion of *Gartenberg* as currently applied because it incorporates more evidence into the analysis of objective fairness and also incorporates other procedural requirements of the ICA into the private action. In support of their argument, the shareholders point to the text of § 36(b) of the ICA. They point out that § 36(b) uses the term "fiduciary duty," a term which had a "set" common law meaning. According to the comments to the Restatement of Trusts, common law fiduciary duty required both full and accurate disclosure to the beneficiary of all material facts of the transaction as well as a transaction that is fair to the beneficiary.<sup>73</sup> The shareholders argued that the Court should presume that the fiduciary duty in § 36(b) is the

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70. Brief for the United States as Amicus Curiae Supporting Petitioners, *supra* note 25, at 14 (citing 15 U.S.C.A. §§ 80a-15(c) and 80b-6).

71. Brief for Petitioners, *supra* note 41, at 17.

72. *Id.* at 34.

73. *Id.* at 21-22 (citing RESTATEMENT (SECOND) OF TRUSTS § 2 cmt. b; RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. g.).

same as the common law fiduciary duty because, according to the canons of statutory construction, when Congress incorporates an established common law term into a statute, Congress is presumed to incorporate the common law meaning of that term.<sup>74</sup> The shareholders claim that Congress' intent to incorporate the traditional common law trust definition of "fiduciary duty" into § 36(b) of the ICA is further supported by the Court's decision in *Pepper v. Litton*, where they stated that even where a fiduciary has made full disclosure, the court should still closely review it for fairness.<sup>75</sup> Although they disagree with some of the "gloss" that later cases have applied to this standard,<sup>76</sup> the petitioners argue that the core of the *Gartenberg* standard correctly incorporates this common law foundation where it states: "an adviser breaches its fiduciary duty under § 36(b) when it charges a fee that exceeds what could be obtained in an arm's-length transaction"<sup>77</sup>

Second, the petitioners claim that the standard applied by the Seventh Circuit conflicts with the purpose of the ICA.<sup>78</sup> The petitioners argue that while the court below looked to the wrong situation when incorporating the common law rules surrounding a fiduciary duty: it erred by comparing the facts of this case—a captive mutual fund—to a situation where a trust is created, rather than an ongoing trust relationship.<sup>79</sup> Petitioners claim that while a trust is created, the parties engage in arms-length bargaining, but an ongoing trust relationship triggers additional duties for the fiduciary.<sup>80</sup> They assert that the Seventh Circuit's conclusion that board approval was "conclusive" conflicts with the plain language of the ICA stating that "director approval should be afforded only 'such consideration by the court as is deemed appropriate under all the circumstances.'"<sup>81</sup> In their effort to discredit the Seventh Circuit's new standard, Petitioners then attack the Seventh Circuit's analogies to other sources of law applied in the opinion.<sup>82</sup> The shareholders claimed that the circumstances that mutual funds operate are entirely different

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74. *Id.* at 20 (citing *Neder v. United States*, 527 U.S. 1, 21 (1999)).

75. *Id.* at 25–28 (citing *Pepper v. Litton*, 308 U.S. 295, 306 (1939)).

76. *Id.* at 33 n. 25.

77. *Id.* at 33.

78. *Id.* at 34.

79. *Id.* at 34–37.

80. *Id.* at 37.

81. *Id.* at 38 (citing 15 U.S.C.A. § 80a-15(a)(2)).

82. *Id.* at 40 (stating that the fiduciary duty of a mutual fund adviser is unlike that of a lawyer or corporation because in the case of the former conflicts of interest occur much more often).

than the other businesses the Seventh Circuit compares, because they lack a true competitive market.<sup>83</sup> The petitioners point to the avowed purposes of the ICA found in the Act's legislative history and argue that, contrary to the Seventh Circuit's decision to rely on the market, Congress amended the Act because it did not trust markets to manage mutual fund fees in light of the potential for conflicts of interest.<sup>84</sup>

### *Respondent's Arguments*

Harris makes three arguments in its defense of the district court's decisions. Notably, the respondent supports a return to the *Gartenberg* standard, and does not support the standard set forth in the Seventh Circuit's decision.<sup>85</sup> Instead, Harris's arguments all attempt to support its position under the *Gartenberg* standard, which the district court used to decide the case.<sup>86</sup>

First, Harris attacks the petitioners' proposed standard using textual arguments.<sup>87</sup> It focuses on the fact that the burden of proof is on the plaintiff to prove that they the fee could not have been reached at an arm's-length.<sup>88</sup> Respondent rejects the second prong of the petitioners' proposed fiduciary standard, and claims that Congress intentionally wrote the ICA in a way that avoided a "reasonableness" test.<sup>89</sup> It relies on the structure of § 36(b)<sup>90</sup> and the Senate's change in the ICA bill from wording that included "reasonableness" to "fiduciary duty."<sup>91</sup> Respondent then attacks the first prong of the petitioners' standard by claiming that there is no right of action for violations of board procedure in deciding fees<sup>92</sup> and notes that "[s]ection 36(b) is sharply focused on the question of whether the fees themselves were excessive."<sup>93</sup> It argues that under the correct *Gartenberg* standard "the adviser-manager must charge a fee that is so

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83. *Id.*

84. *Id.* at 41–48.

85. See Brief for Respondent at 26, *Jones v. Harris Assocs.*, No. 08-586 (U.S. Aug. 27, 2009) (lacking any argument supporting the Seventh Circuit's decision to disapprove of *Gartenberg*).

86. *Id.* at 25–49.

87. *Id.* at 26–32.

88. *Id.* at 28.

89. *Id.* at 32–33.

90. See *id.* (creating a duty for the plaintiffs to prove a breach of fiduciary duty, rather than the normal duty for the defendants to prove no breach).

91. *Id.* at 36 (citing H.R. REP. NO. 89-2337, at 142–44 (1966)).

92. *Id.* at 44–46. Both the district and appellate courts applied the same analysis.

93. *Id.* at 44 (citing *Migdal v. Rowe Prince Fleming Int'l*, 248 F.3d 321, 328 (4th Cir. 2001)).

disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining," to constitute a violation.<sup>94</sup>

The respondent's second argument focuses on the potential policy ramifications inherent in the petitioners' two-prong test: higher fees passed on to investors. The respondent claims that the petitioners' two-prong standard would "doom" any mutual fund adviser to a trial.<sup>95</sup> It argues that the "fairness" (first) prong of the petitioners' proposed standard would be nearly impossible to prove on summary judgment because of the possible expert testimony that stated the fees "should have been resolved differently."<sup>96</sup> Similarly, Respondent asserts that the "fair process" (second) prong would always lead to a trial because there would be an issue of fact as to whether some board member or another was "interested."<sup>97</sup> The massive costs of litigation would force advisers to prepare for potentially far greater liability, which would force advisers to charge significantly higher fees to investors.<sup>98</sup> The respondent contends that "[t]he real advantages to petitioner's standard are the benefits that accrue to lawyers."<sup>99</sup>

The respondent puts forth a final argument in the event that the Seventh Circuit opinion is overturned. The respondent draws the Court's attention to the district court opinion where the *Gartenberg* standard was applied in the "disproportionately large" manner that the respondent supports, and emphasize the fact that the district court found "the *Gartenberg* 'factors' all weigh against Petitioners."<sup>100</sup> The respondent argues that even if the Supreme Court overturns the standard that the Seventh Circuit established when they disapproved *Gartenberg*, the motion for summary judgment should be upheld since the district court's legal and factual analysis was undisturbed by the appellate court.<sup>101</sup>

## VII. LIKELY DISPOSITION

This case seems destined for a reversal that addresses the applicable standard but affirms the judgment. The vehement dissent

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94. *Id.* at 26, (citing *Gartenberg v. Merrill Lynch Asset Mgmt.*, 694 F.2d 923, 928 (2nd Cir. 1982)).

95. *Id.* at 49.

96. *Id.*

97. *Id.* at 50.

98. *Id.* at 51.

99. *Id.* at 51.

100. *Id.* at 53.

101. *Id.* at 54–55.

by Judge Posner in the Seventh Circuit's denial of rehearing en banc makes strong arguments, supported by voluminous academic research, that the appellate opinion's economic reasoning was flawed.<sup>102</sup> The amicus curiae brief of the Solicitor General also adds weight to the petitioners' arguments for a more encompassing review of all the circumstances in a § 36(b) claim rather than the limited standard the Seventh Circuit established and a return to a definition consistent with SEC regulations that relied on the previous circumstances.<sup>103</sup> Even the respondent seems prepared for the standard to be overturned, as its final argument in its brief reminds the Court that they were awarded summary judgment by the district court using the *Gartenberg* standard.<sup>104</sup> It is likely that the Supreme Court will vacate the new standard created by the Seventh Circuit and reaffirm the *Gartenberg* standard, thus resolving the circuit split and restoring consistency across this federal common law issue. While the petitioners' proposed standard expands the narrow action established under the ICA too far, by accepting the Seventh Circuit's standard the action is effectively read out of existence. The Court may, however, be reluctant to overturn the findings of the trier of fact and choose to affirm the initial entry of summary judgment.

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102. See *Jones v. Harris Assocs.*, 537 F.3d 728, 730 (7th Cir. 2008) (Posner, J., dissenting) (*Jones III*).

103. See Brief for the United States as Amicus Curiae Supporting Petitioners, *supra* note 25, at 14.

104. Brief for Respondent, *supra* note 85, at 54–55.