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Litigators of the Week: A Rock-Solid Win for Skadden Trio

By Jenna Greene
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Skadden, Arps, Slate, Meagher & Flom partners Eben Colby, Scott Musoff and James Carroll are our Litigators of the Week. The trio delivered a $1.5 billion save for BlackRock in one of the biggest—if not the biggest—mutual fund cases ever.

After an eight-day bench trial before U.S. District Judge Freda Wolfson in the District of New Jersey, the Skadden team won complete dismissal of claims that the company violated Section 36(b) of the Investment Company Act.

They discussed the case with Lit Daily.

Who is your client and what was at stake?

Colby: Our client is BlackRock, the world's largest asset manager. The firm manages almost $6 trillion across a full spectrum of products for clients in over 100 countries.

At stake in this case were the fees in two of BlackRock's largest mutual funds. The plaintiffs, who are shareholders in the funds, brought a claim under Section 36(b) of the Investment Company Act alleging that the fees were excessive.

Musoff: Section 36(b) is unique in that it makes it a breach of an adviser's fiduciary duty to receive excessive fees from a fund that it manages. It was enacted to protect against potential conflicts of interest in the relationship between an adviser and funds it manages. This type of relationship is arms-length, but one in which the adviser typically sponsors the fund and has broad responsibility for its operations.

Eben Colby, Scott Musoff and James Carroll, Skadden, Arps, Slate, Meagher & Flom.

How did you come to be involved in the case?

Carroll: Our firm has represented BlackRock since its inception in a number of matters. It has been a terrific partnership.

Who was plaintiff's counsel? Was there anything novel about the claims they asserted against BlackRock?

Musoff: Plaintiffs were represented by Andrew Robertson, of Zwerling, Schachter and Zwerling, and Szaferman Lakind. Robertson used to be on our side of the "v," defending these types of cases, so he is quite knowledgeable about mutual funds and this area of law.

Carroll: One way in which this case was unique was the enormous size of the funds at issue. They are highly successful and had grown to over $30 billion

and $50 billion. As you can imagine, even though their fees are low compared to similar funds, with funds of that size the amount at stake in the litigation was significant—plaintiffs' alleged damages were more than $1.5 billion.

Colby: There are a number of 36(b) cases out there right now under a couple of different theories. This was the first so-called "subadviser" case to go to trial.

For the funds at issue, BlackRock was responsible for all of the day-to-day operations of the funds, from investing the money to handling shareholder transactions. But BlackRock, like most asset managers, also manages accounts for other firms under the same investment mandate. Here, it acted as a subadviser for seven funds offered by insurance company clients as investment options in variable annuity products.

The fees for that type of work are typically much lower because the services are far more limited—BlackRock invests the dollars for the fund, but the insurance company is responsible for all of the other things required to offer a fund to the market.

Plaintiffs argued that the difference in services provided were actually negligible, that the lower subadvisory fee rates are really what should have been charged to BlackRock's own funds, and anything above those rates was "excessive." We had to show the court that the plaintiffs were wrong about that.

In June of 2018, Judge Wolfson granted partial summary judgment to BlackRock. What did that decision cover?

Carroll: Although an adviser like BlackRock typically manages all of its day-to-day operations, a mutual fund has its own board comprised of a majority of directors who are independent of the adviser. That board annually reviews and approves the fee that the fund pays its adviser. It is a very important process.

Colby: One of the important factors in 36(b) litigation is whether a board is independent and conscientious. In the summary judgment opinion, the court examined the independence, qualifications and conscientiousness of the BlackRock funds' board and concluded that the board was highly qualified, independent and doing a great job in reviewing BlackRock's fees and holding BlackRock accountable. As a result, the court concluded that the board's decision to approve the fees at issue were entitled to great deference.

As you prepared for the bench trial, what was the overarching theme of your case?

Colby: There were three main themes. First, these were great funds with strong investment performance for their shareholders over a long period of time, and all for a very fair price—about half a penny per dollar invested.

Second, shareholders benefited not only from BlackRock's keen investment acumen, but also from its unparalleled sophistication in all of the other areas required to operate a fund. We showed the court BlackRock's incomparable resources, technical know-how, and relentless efforts to measure and improve its operations in all areas, ranging from compliance to risk management to shareholder servicing and vendor oversight.

Third, we showed the court that BlackRock did not provide these types of support services to subadvisory clients. The insurance companies did it themselves. That's why they pay less, and that's why those fees are just not a good comparison to evaluate the BlackRock fund fees. **The trial lasted for eight days in August of 2018. How did your team work together to present your case?**

Carroll: We had a terrific team across the board, but most notable was the degree of involvement by BlackRock's in-house lawyers. Their litigators, Peter Vaughan, Stephen Ahrens and Tommaso Bencivenga, and the firm's General Counsel Chris Meade, were fully embedded with us. They ate, slept and worked in the same suite of war rooms, on the same floor, as the rest of the team.

Musoff: Sleeves were definitely rolled up! Our clients were prepping witnesses, working on cross-examination questions, reviewing transcripts and fully engaged in all facets. It was incredibly valuable substantively, and it turned out to be a lot of fun.

Colby: It was also a classic Skadden effort, in that we had seamless coordination across multiple offices and an invaluable internal trial support team.

What were some of the high points at trial?

Colby: Well, we're not going to lie—there's only a certain segment of society who gets really excited by a deep dive into the world of mutual fund servicing, operations and administration.

But the BlackRock executives who testified did a terrific job of educating the court about those things and how important they are. Mutual funds are among the world's most complex and highly regulated financial instruments, and our witnesses' depth of knowledge and genuine zeal for their work made it accessible to a lay audience. They were great explainers!

Musoff: There were also some genuinely dramatic moments too. Our cross of plaintiffs' expert had it all.

He previously had to make corrections to a best-selling book he authored because he had used material from other sources without proper attribution. Then, a newer paperback version of his book jacket selectively quoted a couple of positive snippets from the very critical book review that identified the plagiarism in the first place. He had to admit that those selective quotes were misleading.

We also tracked down one of his sources in a footnote that led back to a treatise on valuing dental practices. You can't make that stuff up! It also shows what a team effort this was—one of the more junior members of our team took the time and care to track down the source material, as well as to scrutinize the paperback, and spotted the misleading quotation.

Carroll: This wasn't just a matter of credibility, there was also direct relevance to our case. We discovered and were able to show that the expert had used nearly identical reports in our case and another case, with nearly identical conclusions, even though the funds, fees and businesses at issue were very different.

Did you make any unconventional strategic choices?

Carroll: For one, we did not posit any alternative damages calculation. We were confident in our case and confident that the court would understand that these were great funds at a fair price.

Colby: We also really got into the weeds of the fund business. Sometimes in a trial there is a reflexive inclination to hit the high points and stay out of hard-to-understand complexity. Here, we did the opposite.

We decided to really show the court how overwhelmingly complex the business is. For example, one witness took the court on a detailed tour through the funds' lengthy compliance program. It may not have been scintillating, but it was effective.

I know Judge Wolfson's redacted opinion has not yet been published, but in general, what factors were key to winning the case?

Colby: We could not say it enough during the trial, and we cannot say it enough now: These were great funds at a fair price, and BlackRock's services to them are top notch. We were able to really explain how funds work, and the court took the time and care to really dig in and understand all that BlackRock does for its fund shareholders.

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