Plaintiffs Facing Headwinds in Pending Mutual Fund Fee Litigation

11/22/16

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With the first-filed cases at or near completion, the results are not looking good for the plaintiffs in the latest wave of mutual fund fee litigation. Defendants prevailed after trial in one of those cases and achieved partial victory at summary judgment in two others, including, most recently, a favorable ruling from the bench last week in U.S. District Court for the District of Massachusetts.

These so-called "excessive fee" cases assert claims under Section 36(b) of the Investment Company Act of 1940, which imposes a fiduciary duty on registered investment advisers with respect to the fees they receive from the registered investment companies they manage. To recover damages, plaintiffs must prove that the fee at issue was "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." *Jones v. Harris Assocs., L.P.*, 559 U.S. 335, 346 (2010). Courts will consider all relevant factors when analyzing a claim but must give "considerable weight" to an informed board's decision to approve the fees. *Id.* at 351.

The Section 36(b) standard is difficult to satisfy. Indeed, no plaintiff has prevailed on the merits of a Section 36(b) claim in the more than 40 years since the statute was enacted. Nonetheless, in recent years, at least 26 Section 36(b) cases have been filed across 13 jurisdictions. This new wave focuses principally on a comparison of the services rendered, and the fees received, by the subadvisers and sponsor/advisers to subadvised funds. While the plaintiffs in these cases generally have survived threshold motions to dismiss, they so far have encountered headwinds at the merits stage. The status of the three most advanced cases is as follows:

- *In re Russell Inv. Mgmt. Co. S'holder Litig.*, No. 1:13-cv-12631 (D. Mass.): On November 15, 2016, the court granted summary judgment, in part, in favor of the adviser. The case will proceed to trial on a significantly narrowed area of factual dispute.
- *Kasilag v. Hartford Inv. Fin. Svcs., LLC*, No. 11-1083 (D.N.J. 2016): The court ruled at summary judgment that the board's process was sound and its decision with respect to fees would be entitled to significant deference at trial. The case proceeded to a four-day trial, which concluded on November 16, 2016.
- *Sivolella v. AXA Equitable Life Ins. Co.*, No. 3: 11-cv-4194-PGS-DEA (D.N.J.): On August 25, 2016, following a 25-day bench trial, the court ruled in favor of the adviser on all liability and damages theories. We wrote about the outcome of the *AXA* trial here.

The *Russell* Summary Judgment Decision

In *Russell*, the plaintiff alleged that the adviser received excessive fees from 10 of the mutual funds it managed, on the ground it purportedly delegated all asset management responsibilities to third-party subadvisers but retained a disproportionate amount of the aggregate advisory fee paid by each fund. According to the plaintiff, the portion of the fees retained by the adviser was "nearly 290% greater" than the share received by the subadvisers.

At summary judgment, the adviser demonstrated that the mutual fund boards were comprised of a super-majority of disinterested and well-qualified directors who relied on materials prepared by the adviser, independent counsel and third-party experts regarding factors relevant to the fees at issue. The adviser also presented evidence showing that its advisory fees and the performance of its funds were competitive with peer funds and it rendered significant advisory services to the funds above and beyond those provided by the funds' subadvisers. The plaintiff attempted to blunt the impact of this evidence by arguing that a robust board process alone is, by itself, insufficient to defeat a Section

36(b) claim and urged the court to evaluate the fairness of the fees in light of the purportedly limited range of services performed by the adviser.

On November 15, 2016, Judge William G. Young of the District of Massachusetts granted partial summary judgment in favor of the adviser. Ruling from the bench, Judge Young stated that the board was entitled to deference, as a matter of law, on the decision to approve the fees, but that the plaintiff "probably squeak[s] by summary judgment" on three discrete issues: (i) fall-out benefits, (ii) profitability and (iii) the nature and quality of the adviser's services.

The *Russell* decision is consistent with the other recent Section 36(b) decisions, discussed below, that have adhered to the U.S. Supreme Court's mandate to defer to the business judgment of an informed board.

A trial is scheduled to be held in March 2017.

The *Hartford* Trial

In *Hartford*, the parties completed a four-day trial on November 16, 2016. As in *Russell* (and unlike in *AXA*), the court granted partial summary judgment in favor of the adviser prior to trial, finding that the board's process was sound and its decision with respect to the fees at issue would be entitled to deference at trial.

At trial, the evidence included testimony of five witnesses, including: (i) competing experts in economics and the financial industry, who testified primarily about the services provided by the adviser and subadviser, (ii) competing accounting experts, who testified about the adviser's treatment of subadvisory expenses, and (iii) the adviser's chief investment officer, who testified about the adviser's pricing, services, risk and performance.

Both *Russell* and *Hartford* demonstrate that in Section 36(b) litigation, a robust board process, at a minimum, may narrow the issues for trial. While Section 36(b) cases often involve overly broad and expensive pretrial discovery, the recent *Hartford* trial demonstrates how a court may narrow the case at summary judgment to create a manageable trial focused on certain limited components of a plaintiff's claim.

Closing arguments are set for January 2017, to be preceded by post-trial briefing. We expect a decision in spring 2017 or thereafter.

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The first post-*Jones* cases to be adjudicated are likely to influence the outcome of pending and future litigation under Section 36(b). So far, district courts have taken seriously the Supreme Court's instruction in *Jones* to defer to an informed board's judgment, and plaintiffs have struggled to gain traction at the merits stage. We expect continued focus in litigation on the board's composition and process, as well as on the board's consideration of the plaintiffs' particular criticisms of the advisory fees at issue. Unless and until plaintiffs can identify a material flaw in a board's process or consideration of the facts surrounding the fee, it appears that they will continue to have difficulty prevailing on the merits.