Client Alert.

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Court Reinstates Summary Judgment for Adviser in Excessive Fee Case

By Jay G. Baris

On March 30, 2012, the United States Court of Appeals for the Eighth Circuit reversed itself and granted summary judgment to Ameriprise Financial, Inc. and its affiliates ("Ameriprise") in a suit filed by shareholders of mutual funds advised by Ameriprise.[1] The plaintiffs alleged that the adviser breached its fiduciary duty under Section 36(b) of the Investment Company Act of 1940 (the "1940 Act") with respect to fees charged to the funds.

The original complaint in *Gallus v. Ameriprise Financial, Inc.*[2] alleged that the adviser breached its Section 36(b) fiduciary duties by charging excessive advisory fees to the mutual funds that it managed. Among other things, the plaintiffs claimed that Ameriprise charged its institutional clients substantially lower fees than it charged the other shareholders. In addition, they alleged that Ameriprise misled the board about these arrangements to prevent them from questioning the higher fees charged to the funds. The district court granted summary judgment to Ameriprise, applying the standards set forth in *Gartenberg v. Merrill Lynch Asset Management, Inc.*[3] That is, the court said that the plaintiffs failed to show a genuine issue of material fact that the fees Ameriprise charged "were so disproportionately large that they bear no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining."

On appeal, the Court of Appeals for the Eighth Circuit reversed the district court's ruling, holding that while the advisory fees passed muster under the *Gartenberg* test, the district court erred in rejecting a comparison between fees charged to institutional clients and other mutual fund clients, and that Ameriprise allegedly misled the fund's board.[4] The rationale for the court's original holding was that excessive fees are not the only way that a board can breach its fiduciary duties to its shareholders under the 1940 Act. More specifically, the court held that "the proper approach to § 36(b) is one that looks to both the adviser's conduct during negotiation and the end result. Unscrupulous behavior with respect to either can constitute a breach of fiduciary duty."[5]

THE SUPREME COURT'S DECISION IN THE *JONES* CASE

After the Eighth Circuit's reversal in *Gallus I*, the United States Supreme Court, in *Jones v. Harris Associates L.P.*,[6] clarified what a mutual fund shareholder must prove in order to show that a mutual fund investment adviser breached its Section 36(b) fiduciary duties with respect to its receipt of advisory fees. The Supreme Court held that "*Gartenberg* was

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[1] *Gallus v. Ameriprise Financial, Inc.*, 2012 WL 1058976 (8th Cir., 2012) ("*Gallus II*").

[2] 561 F.3d 816 (8th Cir. 2009) ("Gallus I").

[3] 694 F.2d 923 (2d Cir. 1982).

[4] *See Gallus I.*

[5] *Gallus I*, 561 F.3d at 823 (citation omitted).

[6] 130 S. Ct. 1422 (2010).

correct in its basic formulation of what § 36(b) requires: to face liability under § 36(b), an investment 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."[7]

The Supreme Court subsequently vacated the decision in *Gallus I* and remanded the case to the Eighth Circuit, which remanded to the district court for further consideration. The district court reinstated its early decision granting summary judgment to Ameriprise, and the plaintiffs brought the *Gallus II* appeal before the Eighth Circuit.

RECONSIDERATION OF GALLUS BY THE EIGHTH CIRCUIT IN LIGHT OF *JONES*

"*Jones* has altered the way in which we determine whether an adviser has breached its fiduciary duty under § 36(b),"[8] the Eighth Circuit said.

After *Jones*, "a process-based failure alone does not constitute an independent violation of § 36(b)," the court said. Rather, any inquiry must be "sharply focused on the question of whether the fees themselves were excessive."[9] Thus, the court looked solely at the issue of whether the adviser charged "a fee that is so disproportionally large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's length bargaining."[10]

The court said that the fund board's decision-making process "can fairly be described as robust."[11] In light of the fact that the board was not fully informed of all the relevant facts, it questioned how much deference it should give to the board's conclusions.

Nonetheless, the court said that in light of the *Jones* decision, after considering all relevant circumstances, the benchmark for reviewing challenged fees is 'the range of fees that might result from arm's-length bargaining.'"[12]

The court discussed how much deference it should give to the fund board's deliberations. Citing *Jones,* the court said it would give more deference to the board's approval when the "process for negotiating and reviewing investment-adviser compensation is robust." On the other hand, when the "board's process was deficient or the adviser withheld important information, the court must take a more rigorous look at the outcome."[13]

The court then addressed the plaintiffs' factual assertions, including the disparities between the fees charged to the adviser's institutional clients and the funds; that the adviser retained the economies of scale it realized from the funds; that the adviser retained excessive "fall-out" benefits from its relationship with the funds; and the funds' poor performance. It said that the lower court concluded that the plaintiffs' evidence was insufficient to meet the *Gartenberg* standard. The court agreed. Nothing in the *Jones* decision requires the court to revisit those arguments, the court said, and thus the lower court's decision to grant summary judgment must stand.

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[7] *Id.* at 1426.

[8] *Gallus II,* at *3.

[9] *Id.* at *2 (quoting *Jones,* 130 S. Ct. at 1430).

[10] *Id.* at *3.

[11] *Id.* at *4.

[12] *Id.* (*quoting Jones*, 130 S. Ct. at 1427).

[13] *Id.*

CONCLUSION

Gallus II reminds us that in the post-*Jones* world, the *Gartenberg* factors continue to serve as the primary benchmark for measuring an adviser's breach of fiduciary duty in excessive fee cases.

Gallus II illustrates how the courts will apply the *Jones* case in excessive fee cases. Fund directors should know that board process and independence matter. But, while courts will look at board independence and process when determining how much deference it will give to the board's conclusions, plaintiffs must provide evidence to meet the *Gartenberg* standard if they are to survive a motion for summary judgment.