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DEVELOPMENTS IN LITIGATION INVOLVING MUTUAL FUNDS AND INVESTMENT ADVISERS

APRIL 2015

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Milbank.com

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I. INTRODUCTION

In September 2003, the mutual fund industry came under fire from various law enforcement authorities with allegations of improper or illegal trading practices involving numerous mutual funds. The allegations began with an investigation and complaint filed by the office of the New York State Attorney General ("NYAG") against Canary Capital Partners LLC, a New Jersey-based hedge fund. The NYAG alleged that four mutual fund managers permitted Canary to engage in "late trading" and "market timing" activity. Although the NYAG and Canary settled those charges, the focus on the mutual fund industry continued to intensify. The Canary settlement, among other NYAG initiatives, led to widespread scrutiny by regulators, legislators, and the plaintiffs' bar of nearly every aspect of the mutual fund industry. Since September 2003, federal and state offices and agencies and private organizations and individuals have challenged such widely accepted practices as revenue sharing, directed brokerage, Rule 12b-1 plans and fees, and so-called "soft dollar" commissions. Indeed, the enhanced scrutiny of the industry led to numerous congressional hearings and proposed legislation, various agency investigations, and hundreds of lawsuits.[1]

Many of the lawsuits that resulted from this enhanced scrutiny into industry practices have generated important precedent for mutual fund litigation under the Investment Company Act of 1940, 15 U.S.C. § 80a-1 et seq. (the "Act"), and the securities laws generally. Indeed, courts have issued more decisions concerning the Act in the last decade than in the previous thirty-five years. These decisions have focused on the nature and scope of claims under Sections 36(b) of the Act and the factors courts must consider when evaluating claims for excessive fees under Section 36(b).[2]

Investment advisers have been largely successful in defending many of the recent civil lawsuits. The issue of whether there are implied rights of action under various sections of the Act has been decided resoundingly in the negative. As such, essentially the only avenue for private plaintiffs to sue under the Act has been Section 36(b), which provides an express private right of action. Courts have been reluctant to expand that section to allow challenges based on anything other than excessive fees, and plaintiffs bringing an excessive fee claim are required to meet a very high standard of proof to recover under the statute. On March 30, 2010, the Supreme Court of the United States decided Jones v. Harris Associates L.P., 559 U.S. 335 (2010), and expressly adopted the standard established by the United States Court of Appeals for the Second Circuit more than thirty years ago in Gartenberg v. Merrill Lynch Asset Management, Inc., 694 F.2d 923 (2d Cir. 1982). Under Jones, "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

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1 See Sean M. Murphy & Carrie A. Bassel, "Mutual Funds Under Scrutiny: An Overview of Recent Litigation," Andrews Sec. Litig. & Reg. Rep. (Feb. 23, 2005); James N. Benedict, et al., "A Perfect Storm: Analyzing the Recent Explosion of Mutual Fund Litigation," 1 Sec. Litig. Rep. 20 (Sept. 2004).

2 See James N. Benedict et al., "The Aftermath of the Mutual Fund Crisis," 38 Rev. of Sec. & Commodities Reg. 261 (Dec. 7, 2005).

rendered and could not have been the product of arm's length bargaining." Jones, 559 U.S. at 346. The decision affirms a standard that makes it difficult to prove a violation of Section 36(b).

In spite of the high barrier erected by the Jones/Gartenberg standard, however, plaintiffs have filed new cases at an incredible pace in the last several years. These recent cases generally fall into two types. One type of case challenges the fees for funds that rely on sub-advisers for the provision of investment advisory services, a practice that is particularly prevalent in the insurance industry. These so-called "manager of managers" cases assert that the sub-advisers are performing, with minor exceptions, all of the investment management services but only receive a "fraction" of the fee paid to the manager. The second type of these cases are "reverse" manager of managers cases, which assert that a manager's fee is excessive because it is substantially higher than the fee the manager charges as a sub-adviser to other fund complexes. These cases are the new frontier of Section 36(b) litigation, and generally involve the investment manager trying to delineate the services provided by the manager versus the sub-advisers, as well as to explain why sub-advisers are willing to provide day-to-day advisory services for a fraction of the total management fee.

With non-excessive fee claims under the Act significantly restricted, private plaintiffs have also continued to find other potential theories of recovery to attack the fund industry. For instance, plaintiffs have filed numerous class action complaints against fund advisers and other industry participants under the Securities Act of 1933, the Securities Exchange Act of 1934, the Employee Retirement Income Security Act of 1974 ("ERISA"), and the Racketeer Influenced and Corrupt Organizations Act ("RICO"), as well as state and common law causes of action. Decisions on these different theories of liability continue to emerge, with mixed results for the mutual fund industry.

This Outline discusses recent developments and decisions involving these and other topics.

II. TYPES OF MUTUAL FUND ACTIVITY UNDER SCRUTINY

A. The "Pure" Excessive Fee Cases

Beginning in early 2004, plaintiffs began filing a new wave of complaints against the investment advisers of a dozen major mutual fund complexes in federal courts across the nation. Plaintiffs allege in these "pure" excessive management fee actions that the advisers received excessive advisory fees for managing funds in breach of their fiduciary duty under Section 36(b) of the Act. Many of these lawsuits focus on allegations that the advisory fees were excessive because they were higher than those paid by institutional investors for essentially the same advisory services and did not reflect economies of scale. These lawsuits are a challenge to the well-established holdings in Gartenberg v. Merrill Lynch Asset Mgmt. Inc., 694 F.2d 923 (2d Cir. 1982), cert. denied sub nom. Andre v. Merrill Lynch Ready Assets Trust, 461 U.S. 906 (1983), and its progeny, which twenty years earlier rejected comparisons between fees paid by retail fund investors and institutional clients, at least in the money market context.

The pure excessive management fee cases proceeded at different paces, and now all but one of them have been closed. The case against Neuberger Berman was dropped without

explanation by plaintiffs or any payment to them. See Krueger v. Neuberger Berman Mgmt., Inc., No. 05-1316 (S.D.N.Y. May 20, 2005). The case involving the American Century family of funds was scheduled for trial in August 2006 and would have been the first major Section 36(b) case to be tried in almost two decades. At issue was more than $1 billion in fees paid by three funds from March 2003 through July 2006. During the course of pre-trial proceedings, Defendants filed a motion in limine seeking to preclude plaintiffs from presenting evidence pertaining to non-mutual fund accounts, arguing that such evidence is irrelevant to a claim that mutual fund fees are excessive under Section 36(b). On July 17, 2006, the court granted Defendants motion in its entirety, holding that evidence relating to American Century's management of non-mutual fund institutional accounts, such as pension funds and subadvised accounts, are irrelevant to a claim under Section 36(b). See Baker v. Am. Century Inv. Mgmt., Inc., No. 04-4039-CV, slip op. (W.D. Mo. July 17, 2006). On July 31, 2006, just a week before trial was scheduled to begin, plaintiffs agreed to dismiss the action, expressly acknowledging that the case was without merit and that American Century did not violate Section 36(b) because the fees it received from the funds were reasonable. The stipulation of dismissal states that after prosecuting the action, "it is likely that the Defendant will prevail on most of [the relevant] issues," and that "if the case were tried, the Court would likely determine that the compensation Defendant received for managing the Funds was fair and reasonable." Baker v. Am. Century Inv. Mgmt., Inc., No. 04-4039-CV, stip. of dismissal (W.D. Mo. July 31, 2006). Based on plaintiffs' concession that the case had no merit, the court ordered the case dismissed with prejudice. See Baker v. Am. Century Inv. Mgmt., Inc., No. 04-4039-CV, order (W.D. Mo. July 31, 2006).

Two months later, another of the pure excessive management fee cases scheduled for trial was settled for an undisclosed amount just weeks before the scheduled trial date. See Williams v. Waddell & Reed Inv. Mgmt. Co., No. 04-2561, stip. of dismissal with prejudice (D. Kan. Sept. 25, 2006). And one day later, on September 26, 2006, the United States Court of Appeals for the Second Circuit affirmed the dismissal of an earlier pure excessive management fee case against Morgan Stanley that had been filed in 2003, prior to the mutual fund crises. See Amron v. Morgan Stanley Inv. Advisors, Inc., 464 F.3d 338 (2d Cir. 2006). On January 25, 2007, the excessive management fee case against AIM/Invesco was settled for an undisclosed amount. See Hunt v. Invesco Funds Group, Inc., No. H-04-2555, slip op. (S.D. Tex. Jan. 29, 2007). The action against Janus was similarly settled on May 1, 2007. See Sins v. Janus Capital Mgmt., LLC, No. 04-cv-1647 (D. Colo. May 1, 2007). On August 9, 2007, the excessive fee case against Franklin was settled for an undisclosed amount. See Strigliabotti v. Franklin Resources, Inc., No. 04-883 (N.D. Cal. Aug. 9, 2007). On February 27, 2007, the case against the Oakmark family of funds was dismissed by summary judgment. See Jones v. Harris Assocs., L.P., No. 04 C 8305, 2007 WL 627640 (N.D. Ill. Feb. 27, 2007). Similarly, on July 10, 2007, a virtually identical action brought against Ameriprise was also dismissed by summary judgment. See Gallus v. Ameriprise Fin., Inc., 497 F. Supp. 2d 974 (D. Minn. 2007), aff'd, 675 F.3d 1173 (8th Cir. 2012). Proceedings continue in Jones in light of the Supreme Court's decision.

One pure excessive management fee case, however, brought against the American Funds advised by Capital Research, did proceed all the way to trial, representing the first time in

more than twenty years that a Section 36(b) case was fully tried on the merits. Following the trial, Judge Feess of the Central District of California issued a 105-page opinion that entered judgment for defendants after deciding all of the major substantive issues presented, including each of the Gartenberg factors, in defendants' favor. See In re Am. Mutual Funds Fee Litig., No. CV 04-5593, 2009 WL 5215755 (C.D. Cal. Dec. 28, 2009). The ruling was affirmed by the Ninth Circuit. Jelinek v. Capital Research & Mgmt. Co., 448 F. App'x 716 (9th Cir. 2011).

B. "Manager of Managers" Excessive Fee Cases

More recently, plaintiffs have filed a new series of Section 36(b) cases against over a dozen investment advisers. At the outset, these "manager of managers" cases primarily involved challenges to the fees charged by funds that rely on sub-advisers for the provision of investment advisory services. Plaintiffs assert that the sub-advisers are performing, with minor exceptions, all of the investment management services but only receive a "fraction" of the fee paid to the manager. AXA, Harbor Capital, The Hartford, ING, New York Life, Principal Management, Russell Investments, and SEI are defending such claims. In 2014, plaintiffs brought a handful of "reverse" manager of managers cases alleging a variation of the claim, namely that a manager's fee is excessive because it is substantially higher than the fee the manager charges as a sub-adviser to other fund complexes. BlackRock, Davis Advisors, First Eagle, and J.P. Morgan have been sued under this theory.

Although several of the defendants have moved to dismiss both types of plaintiffs' "manager of managers" claims, they have been widely unsuccessful. See Sivolella v. AXA Equitable Life Insurance Co., No. 11-4194, 2012 WL 4464040 (D.N.J. Sept. 25, 2012); Kasilag v. Hartford Investment Financial Services, LLC, No. 11-1083, 2012 WL 6568409 (D.N.J. Dec. 17, 2012); Am. Chems. & Equip., Inc. 401(K) Ret. Plan v. Principal Mgmt. Corp., No. 14-00044, 2014 WL 5426908 (S.D. Iowa Sept. 10, 2014); Zehrer v. Harbor Capital Advisors, Inc., et al., No. 1:14-cv-00789, 2014 WL 6478054 (N.D. Ill. November 18, 2014); Goodman v. J.P. Morgan Investment Management, Inc., No. 2:14-cv-414, 2015 WL 965665 (S.D. Ohio Feb. 4, 2015); In re BlackRock Mutual Funds Advisory Fee Litigation, No. 14-1165, 2015 WL 1418848 (D.N.J. Mar. 27, 2015). AXA is the only defendant that has filed a motion for summary judgment. The other cases are currently awaiting decisions on motions to dismiss, or are engaged in discovery.

C. Distribution Practices—Directed Brokerage, Revenue Sharing, and Rule 12b-1

In the aftermath of the September 2003 NYAG investigation of Canary Capital Partners, a spotlight was turned on well-settled industry practices involving distribution of mutual fund shares, leading to regulatory and Congressional investigations in addition to a plethora of class action lawsuits. Those practices include revenue sharing, directed brokerage, and Rule 12b-1 plans and fees. As a result of the increased regulatory scrutiny of these distribution practices, private plaintiffs filed numerous complaints against various investment advisers, distributors, and individual defendants (e.g., non-interested or independent trustees or directors and/or the funds themselves), including

Alliance Capital, Capital Research, Citigroup, Dreyfus, Federated, Fidelity, ING, Merrill Lynch, MFS, and UBS, to name a few, alleging inappropriate or illegal conduct. As discussed in greater detail below, the overwhelming majority of these so-called revenue sharing cases have been dismissed, in whole or in part, by a variety of district courts. In response, plaintiffs have filed amended complaints in many of these cases and have now included allegations that appear to be based more on traditional, "pure" excessive management fee claims than on the distribution practices previously complained of, presumably in the hope that such allegations will survive judicial scrutiny on a motion to dismiss.

1. Directed Brokerage and Revenue Sharing

Revenue sharing generally refers to an arrangement whereby a mutual fund sponsor/adviser, or its affiliate, agrees to pay a broker-dealer fees on top of sales commissions and other fees in return for certain marketing benefits from the broker-dealer. Until the practice was prohibited by the SEC, see Prohibition on the Use of Brokerage Commissions to Finance Distribution, 69 Fed. Reg. 5472 (Sept. 9, 2004), many fund families made revenue sharing payments to broker-dealers using directed brokerage—that is, by directing their funds to execute portfolio transactions through the specified broker-dealers in exchange for the brokers' distribution of fund shares.

Throughout 2004, plaintiffs filed class actions against more than twenty investment advisers claiming that the advisers (and/or their affiliates) improperly used Rule 12b-1 fees and directed brokerage to pay brokers to aggressively recommend the advisers' funds over other funds, and that such payments were not properly disclosed to investors, but were instead disguised as brokerage commissions. Plaintiffs alleged violations of various sections of the Act, including Sections 34(b), 36(a), and 36(b), Sections 206 and 215 of the Investment Advisers Act of 1940, and common law. Plaintiffs also targeted broker-dealers. These actions have been termed "broad form," as opposed to "pure."

As described in greater detail below, the overwhelming majority of these directed brokerage and revenue sharing actions asserted against investment advisers have been dismissed. However, at least two of the actions that were originally asserted as revenue sharing class actions—against the advisers and/or affiliates for the American Funds and the Salomon Smith Barney-branded families of mutual funds—have been repleaded as "pure" excessive fee actions. The American Funds action was tried on the merits in July and August of 2009 and dismissed in its entirety with prejudice. See In re Am. Mutual Funds Fee Litig., No. CV 04-5593, 2009 WL 5215755 (C.D. Cal. Dec. 28, 2009). The Salomon Smith Barney action was twice dismissed on motion, decisions that were substantially affirmed by the Second Circuit. See In re Salomon Smith Barney Mutual Fund Fees Litig., 441 F. Supp. 2d 579 (S.D.N.Y. 2006), and In re Salomon Smith Barney Mutual Fund Fees Litig., 528 F. Supp. 2d 332 (S.D.N.Y. 2007), aff'd in part, vacated in part sub nom. R.W. Grand Lodge of F. & A. M. of Pa. v. Salomon Bros. All Cap Value Fund, 425 F. App'x 25 (2d Cir. 2011).

2. Rule 12b-1

The debate over the use and disclosure of Rule 12b-1 fees is nothing new. Indeed, Rule 12b-1 fees have been the subject of discussion and litigation nearly since the adoption of Rule 12b-1 in 1980. Arguably, Rule 12b-1 fee disclosures that comply with applicable rules under the various securities acts are all that is necessary. However, the SEC has stated that the current level of required disclosures is not "necessarily all the disclosure about these types of fees that should be required as a matter of public policy," and ten years ago indicated an intent to revisit the area at some time in the future. See Brief of the Securities and Exchange Commission, Amicus Curiae, in Response to the Court's Request in Strougo v. Bear Stearns & Co., et al., No. 97-9159, at 24 & n.9 (2nd Cir. Feb. 11, 2000). In 2007, the SEC hosted a roundtable on issues surrounding Rule 12b-1 including the history and purposes of the Rule, current and historical uses of Rule 12b-1, costs and benefits of the Rule, and options for the reform or rescission of Rule 12b-1.

Rule 12b-1 requires directors or trustees of funds to approve a Rule 12b-1 plan by a vote of the majority of the board of directors (or trustees) and to review, at least quarterly, "a written report of the amounts so expended and the purposes for which such expenditures were made." 17 C.F.R. § 270.12b-1(b)(3)(ii). The fund may continue the plan "only if the directors who vote to approve such implementation or continuation conclude, in the exercise of reasonable business judgment and in light of their fiduciary duties under state law and under sections 36(a) and (b) of [the Act], that there is a reasonable likelihood that the plan will benefit the [fund] and its shareholders." 17 C.F.R. § 270.12b-1(e). Various lawsuits allege that there is no "reasonable likelihood" that the Rule 12b-1 plans at issue would benefit the funds and their shareholders, especially considering that economies of scale are not being returned to fund shareholders and additional marketing efforts are, in some cases, creating diminished marginal returns because the increased fund size correlates with reduced liquidity and fund performance.

Other lawsuits complain that investment advisers continue to charge, and directors or trustees continue to approve, Rule 12b-1 fees for marketing and distribution services even though the funds at issue are closed to new investors and, therefore, allegedly require no continuing marketing. According to plaintiffs, there is no reasonable basis for the distribution plan or the payment of distribution fees because the actual distribution costs are de minimis and there is no likelihood that it will benefit the funds and the funds' shareholders. Plaintiffs allege that such conduct violates Section 36(b) and common law fiduciary duties. Plaintiffs complain that the adviser should be enjoined from collecting additional 12b-1 fees from the closed funds and should refund a portion of the investment advisory fees charged to those funds during the alleged breach.

D. Market Timing & Late Trading Activity

1. Nature of the Alleged Wrongdoing

a. Market Timing

The term "market timing" has taken on a meaning in the context of governmental investigations that frequently connotes illegal or improper conduct. This is not how the term has been understood in the past because it can apply to several different types of trading behaviors, much of which has not generally been considered illegal. At its most general, market timing describes any investment strategy where the goal is to capture market gains by being in the market when it rises and being out of the market when it declines. This is also referred to sometimes as asset allocation.

The strategies that traders employ are extremely varied, but generally rely on an analysis of economic or other market indicators to predict when the market or a segment of the market will rise or fall. For example, "time zone arbitrage" involves trading in U.S. mutual funds that have large portions of their portfolios devoted to stocks that trade on foreign markets. It exploits the pricing inefficiency that occurs when a stock's closing price on its home market does not reflect post closing information that will likely have a material impact on the price of the stock once that non-U.S. market opens the next day.

Similarly, "liquidity arbitrage" occurs when certain traders invested in funds that have large holdings of illiquid securities seek to exploit opportunities where the underlying prices of the fund holdings are stale and the NAV of such funds accordingly are temporarily low. The liquidity arbitrageur expects to make a profit when the underlying securities rise in price as current information is reflected in their prices and a fund's NAV is thus brought up to the appropriate level.

However, a trading strategy that involves frequent trading designed to capture almost certain gains by incorporating an improper informational advantage into the trading decision (such as late trading, discussed below) is likely considered to be illegal.

Many mutual funds state in their prospectuses that they prohibit or discourage market timing or frequent trading by imposing early redemption fees when certain holding periods are not observed.

b. Late Trading

Late trading is the practice of making trading decisions after the close of trading (generally, 4:00 p.m. in New York) while getting that day's price or NAV instead of the next day's price, as mandated by the SEC's forward

pricing rule. See 17 C.F.R. §§ 270.22c-1. Thus, a late trader is able to obtain a price that does not incorporate information that becomes public after the close of the markets (e.g., a surprisingly good earnings announcement from a sector leader such as Microsoft). Late trading violates SEC regulations.

c. Conflicts of Interest/Special Treatment

Certain market timers have apparently been permitted to engage in market timing activity that was contrary to a fund's prospectus disclosure, was harmful to the other fund investors regardless of the prospectus disclosure, or were permitted to late trade with the knowledge of individuals employed by the fund's affiliates (e.g., the distributor). The market timers allegedly were permitted to engage in this activity because they bestowed benefits or potential benefits on these fund affiliates. The most common example of this was the placing of additional assets to be managed by the investment adviser, thereby giving the adviser the opportunity to earn additional management fees. These non-market timing investments have been referred to as "sticky" assets. In the view of the government and some academics, these arrangements create a conflict of interest between investment advisers and other fund shareholders because the market timing relationships causes harm to other fund shareholders. Further, the benefit flowing from the sticky assets was allegedly bestowed solely on the adviser and did not benefit the other fund shareholders.

d. Disclosure of Portfolio Holdings

Individuals associated with various funds have allegedly disclosed non-public, detailed portfolio holdings to selected investors. This disclosure gave these recipients an informational advantage over other investors and helped influence market timing and late trading decisions. In addition, such information has apparently been used to develop complicated hedging strategies, including shorting the mutual funds.

2. Entities Involved in Market Timing/Late Trading Investigations

a. Agencies

Various governmental and regulatory entities have investigated or are investigating mutual funds' conduct concerning market timing relationships and late trading, including the SEC, FINRA, the NYAG, the Colorado Attorney General, the United States Attorney for the Southern District of New York and the Massachusetts Secretary of the Commonwealth.

b. Fund Families and Other Entities

> Numerous fund families and other entities are being or have been investigated, including Alliance Capital Management; Bank of America (Columbia Funds); Bank One (One Group Funds); Charles Schwab Corp.; Federated Investors; Fred Alger Management; INVESCO Funds Group; Janus Capital Group; Loomis Sayles & Co.; Pilgrim, Baxter & Assocs.; Prudential/Wachovia; Putnam Investments; and Strong Capital. Many of those same entities were named as defendants in various private lawsuits.

E. Soft Dollars

A considerable amount of attention has been given to the use of so-called "soft dollars." According to the SEC, soft dollar practices are "arrangements under which products or services other than execution of securities transactions are obtained by an adviser from or through a broker-dealer in exchange for the direction by the adviser of fund or client brokerage transactions to the broker-dealer." See SEC, Inspection Report on the Soft Dollar Practices of Broker-Dealers, Investment Advisers and Mutual Funds, Executive Summary (1998). Generally, soft dollar arrangements are used by advisers to obtain research—both proprietary and third-party—from broker-dealers. The adviser receives a bundle of services from the broker-dealer, including research and transaction execution. In exchange, the adviser must comply with (and demand from the broker-dealer) "best execution" for the transactions. Under a typical soft dollar arrangement, the adviser may pay a few cents over an execution-only price.

Section 28(e) of the Securities Exchange Act of 1934 provides a safe harbor for soft dollar transactions, so long as the adviser's soft dollar practices are disclosed to investors. Soft dollar arrangements nevertheless draw criticism because the adviser receives a benefit—research that it would have otherwise had to produce or pay for—using assets entrusted to the adviser through investments in the fund or funds it advises. Complicating matters further is the absence of any clear definition of "research." Indeed, it was not uncommon for advisers to receive "research" in the form of computer hardware and software, newspaper subscriptions, or other products. Moreover, the SEC reported in their 1998 study that a not insignificant number of broker-dealers and advisers gave and/or received non-research products and services in soft dollar arrangements (e.g., office rent and equipment, cellular phone services and personal expenses, employee salaries, client referrals, and marketing expenses). Id.

On July 30, 2008, the SEC proposed guidance "to assist fund directors in approaching and fulfilling their responsibilities of overseeing and monitoring the fund adviser's satisfaction of its best execution obligations and the conflicts of interest that may exist when advisers trade the securities of their client that are funds." Commission Guidance Regarding the Duties and Responsibilities of Investment Company Boards of Directors With Respect to Investment Adviser Portfolio Trading Practices, Exchange Act Release No. 34-58264, 2008 WL 2917621, at *3 (July 30, 2008). According to the Guidance, "[i]t is imperative that the fund's directors both understand and scrutinize the payment of transaction costs by the fund and determine that payment of transaction costs is in the best interests of the fund and the fund's shareholders." Id. at *2 (footnote omitted). To assist directors in scrutinizing payments, the SEC outlined the data fund directors should

seek in connection with their oversight of the investment adviser's duty to seek best execution and consideration of transaction costs, as well as the investment adviser's use of fund brokerage commissions. See id. at *5-9. The Guidance also specifically discusses the safe harbor under Section 28(e) and the types of information that fund boards should seek from the investment adviser in connection with the investment adviser's determination of whether the types of brokerage and research services the adviser obtains using fund brokerage commissions fall within the safe harbor. See id. at *9-10.

Private plaintiffs have joined the fray as well. Plaintiffs have alleged that investment advisers, in violation of their fiduciary duty, retain the benefits of soft dollar arrangements rather than passing them on to shareholders. Plaintiffs have also alleged that the soft dollar arrangements are used to acquire non-research items such as computers and software. Plaintiffs allege these practices constitute violations of various sections of the Act, including Section 36(b).

F. Breakpoints—Scrutiny Regarding Disclosures for Different Classes of Fund Shares

Regulators and private plaintiffs have scrutinized fund disclosures regarding the relative advantages and disadvantages of purchasing Class A shares versus Class B shares. Also under scrutiny are the sales practices of brokers and whether they are steering purchasers towards Class B shares—on which they typically receive a higher commission—and thus away from Class A shares, even though large purchases of Class A shares generally entitle the purchaser to breakpoint discounts on the sales charges associated with those shares.

G. Overinflation of Mutual Funds' NAV

In July 2004, the Northern District of California in In re Van Wagoner Funds, Inc., 382 F. Supp. 2d 1173 (N.D. Cal. 2004), dismissed a complaint with leave to amend against Ernst & Young ("E&Y"). That case alleged that the accounting firm had improperly accounted in shareholder reports and certifications of year end financials for restricted stocks held by the Van Wagoner Funds, Inc. at cost instead of at fair value. Plaintiffs alleged that this accounting caused a material misevaluation of the restricted securities and an overinflation of the fund's NAV. E&Y contended that the Van Wagoner financials were not misleading because they did not contain misstatements as a matter of law and therefore E&Y's approval of such reports was not misleading. The court agreed with E&Y's position and dismissed the complaint. The court noted that Van Wagoner's valuation policy—that of valuing securities at cost—as well as all adverse information about the restricted securities in which the Van Wagoner Funds had invested, such as the issuing company's bankruptcy, withdrawn initial public offerings, etc., meant there could be no misstatement. Finally, the Court found that plaintiffs' Section 10(b)/Rule 10b-5 claim lacked the particularity required under the PSLRA and failed to show that E&Y made any misrepresentations intentionally or with deliberate recklessness.

H. Gifts and Gratuities

Beginning in November 2004, the SEC and the NASD launched an investigation into whether approximately two dozen brokerage firms gave gifts to mutual fund advisers in exchange for directing stock trades to those brokers. See Deborah Solomon, SEC, NASD Investigate Whether Securities Firms Gave Excessive Presents, WALL ST. J., Nov. 24, 2004, at C19. Regulators specifically named fund adviser Fidelity Investments and brokerage firm Jefferies & Co., the latter of which allegedly lavished Fidelity employees with trips to Las Vegas, the Super Bowl, Wimbledon, golf outings, and expensive wines. See Susanne Craig, John Hechinger & Gregory Zuckerman, Fidelity Traders May Catch Heat From Gift Probe, WALL ST. J., Dec. 10, 2004, at C1. In December 2004, several Fidelity brokers were sanctioned and fined by the company amid government and internal investigations. Over fourteen trading employees were disciplined for allegedly receiving gifts and allowing themselves to be wined and dined in exchange for giving various brokers a piece of Fidelity's large trading volume. Two of the fourteen were asked to leave the company. See Susanne Craig & John Hechinger, DeSano Was Among Employees Punished By Fidelity, WALL ST. J., Dec. 20, 2004, at C1. In August 2005, Fidelity received notice from the SEC that investigators were looking into entertainment and gift-giving at the firm.

On December 1, 2006, Jefferies & Co. reached a settlement with the SEC whereby Jefferies agreed to pay $10.3 million to resolve the SEC's investigation. Scott Jones, a member of Jefferies' board of directors and the immediate supervisor of Kevin Quinn, the former Jefferies employee who provided the extensive travel, entertainment, and gifts, also agreed to pay a $50,000 penalty. See In the Matter of Jefferies & Co., Inc. and Scott Jones, Exchange Act Release No. 54861 (Dec. 1, 2006).

On December 14, 2006, Fidelity and the Independent Trustees of the Fidelity Funds, announced that Fidelity would pay $42 million to its funds as restitution for Fidelity traders' receipt of improper travel, entertainment, gifts, and gratuities. The decision followed a lengthy investigation by the Independent Trustees, Judge John S. Martin, Jr., and various consultants (the costs of which will also be paid by Fidelity). See Joe Morris, "Fidelity Paying $42M in Gift Restitution," IGNITES (Dec. 22, 2006). On March 5, 2008, Fidelity reached a settlement with the SEC in which Fidelity neither admitted nor denied wrongdoing. Fidelity agreed to pay $8 million in addition to the $42 million Fidelity previously announced it would turn over to its funds.

I. Subprime Mortgages

Investment advisers have been caught in the recent wave of litigation resulting from the credit crisis that began in 2007. Fidelity, Evergreen, First Trust, MFS, Schwab, Wachovia, State Street, and Morgan Keegan, among other investment advisers, currently are defending against claims that they improperly invested mutual fund assets in "high risk" credit securities, typically CDOs and other securities with exposure to the subprime mortgage market. For the most part, these cases involve allegations that investments in "risky" securities were inconsistent representations in the funds' prospectuses and SAIs, which plaintiffs characterize as promising a "safe" or "low-risk"" investment. Plaintiffs

have brought claims under Sections 11, 12(a)(2), and 15 of the Securities Act and Section 10(b) and Rule 10b-5 of the Securities Exchange Act.

J. ERISA 401(k) Revenue Sharing

Despite plaintiffs' relatively unsuccessful attempts to assert excessive fee claims under the Act based on revenue sharing arrangements, plaintiffs have filed numerous complaints alleging similar practices against investment advisers under the Employee Retirement Income Security Act of 1974 ("ERISA"). In those lawsuits, against some of the nation's largest companies with defined contribution retirement plans and the investment advisers to those plans, plaintiffs generally allege that the company, the sponsors of the retirement plan, the plan's trustee, and the investment adviser to the funds under the plan, breached their fiduciary duties by allowing the plan to incur unreasonable and excessive fees.

In particular, the complaints target revenue sharing arrangements, which typically involve the transfer of assets from investment advisers of the mutual funds offered under the plans to various entities that provide administrative services for those plans. Plaintiffs contend that plan fiduciaries have a duty to both disclose these payments to plan participants, and also to lower the administrative services fees paid by plan participants by the amount of revenue sharing payments the providers receive. Finally, plaintiffs also typically allege that plan sponsors should not have selected retail mutual funds as investment options under the plans, as the fees charged by the mutual funds were excessive by virtue of including revenue sharing payments to third-party entities. Plaintiffs refer to these revenue sharing arrangements in their complaints as the "big secret of the retirement industry."

Plaintiffs have also filed actions that challenge revenue-sharing payments between advisers and plan administrators in a slightly different manner. See, e.g., Columbia Air Servs., Inc. v. Fidelity Mgmt. Trust Co., No. 07-cv-11344 (D. Mass.); Charters v. John Hancock Life Ins. Co., No. 07-cv-11371 (D. Mass.). In these lawsuits, plaintiffs are plan fiduciaries (either sponsors, trustees or administrators), as opposed to plan participants, and defendants are providers of bundled services for the plans, as opposed to the corporations that sponsored them. The allegations in these cases are similar to those made in the other 401(k) cases; namely, that defendants breached their fiduciary duties or otherwise engaged in prohibited transactions under ERISA Section 406 by: (1) receiving kickbacks or revenue sharing payments from mutual funds that were featured on the plan platform; (2) failing to disclose these revenue sharing payments; and (3) only selecting investments that would provide defendants with revenue sharing payments.

Plaintiffs have set forth two primary avenues of recovery against defendants. First, Section 502(a)(2) of ERISA allows plan participants to recover "appropriate relief" against any fiduciary that violates ERISA Section 409. Section 409, in turn, provides that fiduciaries that breach their duties under ERISA are "personally liable to make good to such plan any losses to the plan." Second, Section 502(a)(3) of ERISA provides that plan participants can seek "appropriate equitable relief" to redress any violations of ERISA. Plaintiffs allege that, under Section 502(a)(3), they are entitled to an equitable accounting

of "excess fees and expenses" that have been paid out to the plan's service providers. In some cases, plaintiffs assert that a surcharge should be imposed on defendants for any and all amounts that cannot be properly accounted for.

Hoping for the same success that investment advisers had enjoyed in the revenue sharing cases brought under the Act, many defendants moved to dismiss the complaints. Thus far, the results have been more varied; despite the recent dismissal of several cases, the core allegations of others have survived. One case was tried before the United States District Court for the Western District of Missouri for 16 days in January 2010. See Tussey v. ABB, Inc., No. 06-CV-4305, 2012 WL 1113291 (W.D. Mo. Mar. 31, 2012), aff'd in part, vacated in part, 2014 WL 1044831 (8th Cir. Mar. 3, 2014) (see infra Section V-C for more information).

Finally, it bears noting that while many revenue sharing actions have been brought against corporations without an investment adviser being named as a defendant, this Outline discusses only those actions where investment advisers or their affiliates are present. For a complete picture of the ERISA revenue sharing landscape, interested readers should be aware of the following cases, among others: Loomis v. Exelon Corp., No. 06-cv-4900 (N.D. Ill.); George v. Kraft Foods Global, Inc., 06-cv-798 (S.D. Ill.); Spano v. Boeing Co., No. 06-cv-743 (S.D. Ill.); In re Northrop Grumman Corp. ERISA Litig., No. 07-cv-153 (C.D. Cal.); Taylor v. United Technologies Corp., No. 06-cv-1494 (D. Conn.); Abbott v. Lockheed Martin Corp., No. 06-701 (S.D. Ill.); Braden v. Wal-Mart Stores, Inc., No. 08-cv-3109 (S.D. Mo.); Tibble v. Edison Int'l, No. 2:07-cv-5359 (C.D. Cal.).

K. RICO

In the second half of 2008, plaintiffs filed three different class action complaints in the United States District Court for the Southern District of New York against several mutual fund advisers, including Vanguard, American Century, and Neuberger Berman. A plaintiff filed a similar action against American Century in the Eastern District of California. The plaintiffs assert various class and derivative claims under RICO and state law in connection with certain investments by the mutual funds in internet gaming companies and companies that process payments for internet gaming companies. The plaintiffs claim that these investments constituted a RICO violation because the gaming companies were "illegal gambling businesses," and the funds suffered significant losses when the government began investigating online gambling enterprises beginning in 2006. Plaintiff voluntarily dismissed the action against Neuberger Berman and the action in California against American Century. Stipulation and Order of Voluntary Dismissal in Gamoran v. Neuberger Berman Mgmt. LLC, et al., No. 08 Civ. 10807 (S.D.N.Y. May 19, 2009); Gomes v. Am. Century Cos., Inc., No. 2:09-cv-2513 (E.D. Cal.). The other actions were initially dismissed on motion. Seidl v. Am. Century Cos., Inc., 713 F. Supp. 2d 249 (S.D.N.Y. 2010); McBrearty v. Vanguard Group, Inc., No. 08 Civ. 7650 (DLC), 2009 WL 875220 (S.D.N.Y. Apr. 2, 2009), aff'd 353 F. App'x 640 (2d Cir. 2009), cert. denied, 130 S. Ct. 3411 (2010).

In April 2010, plaintiffs re-filed the case against Vanguard in Delaware Chancery Court. Hartsel v. Vanguard Group, Inc., No. C.A. No. 5394 (Del. Ch.). The case was subsequently dismissed because, inter alia, the complaint was held to be derivative and plaintiffs failed to adequately plead demand excusal. Hartsel v. Vanguard Group, Inc., No. C.A. No. 5394, 2011 WL 2421003 (Del. Ch. June 15, 2011), aff'd, 38 A.3d 1254 (Del. 2012). Plaintiffs re-filed the case once again in the District of Delaware after making a demand on the board of directors. The district court dismissed plaintiffs' claims because they were time barred and because plaintiffs had not established that the board's refusal to pursue plaintiffs' demand for litigation violated Delaware's business judgment rule. Hartsel v. Vanguard Group, Inc., Civ. No. 13-1128, 2015 WL 331434 (D. Del. Jan. 26, 2015).

Similarly, in July 2010, a plaintiff re-filed the case against Neuberger Berman in New York State Supreme Court. Defendants removed that action to federal court and the court denied plaintiff's motion to remand, see Gamoran v. Neuberger Berman Mgmt. LLC, No. 10 Civ. 6234, 2010 WL 4537056 (S.D.N.Y. Nov. 8, 2010), as well as the plaintiff's subsequent motion for reconsideration of the court's decision denying remand, see Gamoran v. Neuberger Berman Mgmt. LLC, No. 10 Civ. 6234, 2011 WL 476620 (S.D.N.Y. Feb. 9, 2011). The court dismissed the action without prejudice in May 2011 after plaintiff made a demand on the funds' board. Gamoran v. Neuberger Berman Mgmt. LLC, No. 10 Civ. 6234, slip op. (S.D.N.Y. May 11, 2011). Plaintiff re-filed his action, but defendants' motion to dismiss was granted without prejudice because plaintiff filed suit prior to the rejection of his demand. Gamoran v. Neuberger Berman Mgmt. LLC, No. 11 Civ. 7957, 2012 WL 2148217 (S.D.N.Y. June 12, 2012). Although plaintiff again re-filed his action, defendants' motion to dismiss was granted yet again without prejudice because the court found that the relevant RICO provision does not apply to passive public stockholders in offshore gambling enterprises. Gamoran v. Neuberger Berman Mgmt. LLC, No. 11 Civ. 7957, 2013 WL 1286133 (S.D.N.Y. Mar. 29, 2013). On October 28, 2013, the Second Circuit finally ended the action by holding that plaintiff failed to make out a "claim of wrongful refusal." Gamoran v. Neuberger Berman Mgmt. LLC, 536 F. App'x 155 (2d Cir. 2013). Significantly, following a concession by plaintiffs' counsel at oral argument, the Second Circuit dismissed the action with prejudice. Id.

In Seidl v. American Century Companies, Inc., No. 10-4152-CV, 2012 WL 7986873 (W.D. Mo. Oct. 31, 2012), the court denied defendants' motion to dismiss a lawsuit that the court described as "one of many lawsuits concerning a mutual fund's liability to its shareholders for investments in an illegal off-shore internet gambling business." Id. at *1. The court found that collateral estoppel did not apply based on a previous case dismissed in New York (Seidl v. Am. Century Cos., Inc., 713 F. Supp. 2d 249 (S.D.N.Y. 2010)), and noted that it would assess defendants' arguments regarding the board of directors' refusal to assert claims following the plaintiff's demand at the summary judgment stage. Id. at 8, 12. On July 2, 2014, the district court granted defendants' motion for summary judgment, holding that the Special Litigation Committee formed to evaluate plaintiff's derivative claims was sufficiently independent, adopted a reasonable methodology, and acted in good faith in electing not to pursue them. Seidl v. Am. Century. Cos., Inc., No. 10-4152-CV, 2014 WL 5463661, at *11-14 (W.D. Mo. July 2,

2014). The order is pending appeal to the Eighth Circuit. Following the dismissal of Gomes v. Am. Century Cos., Inc., No. 2:09-cv-2513 (E.D. Cal.) on the grounds that demand had not been made on the board of directors, the plaintiff also re-filed that case after making a demand on the board. Gomes v. Am. Century Cos., Inc., No. 14-cv-283 (W.D. Mo.).

III. SECTION 36(b)—THE EXPRESS RIGHT OF ACTION FOR BREACH OF FIDUCIARY DUTY WITH RESPECT TO RECEIPT OF COMPENSATION

A. Background of Section 36(b)

Congress passed the Act as a comprehensive federal regulatory scheme to protect investment company shareholders from self-dealing and other abuses that were perceived to be rampant throughout the mutual fund industry. 15 U.S.C. § 80a-1 (1997) (Findings and Declarations of Policy). Unlike the Securities Act of 1933 and the Securities Exchange Act of 1934, which emphasize disclosure, the Act is more regulatory and remedial in nature. The Act contains various prohibitions and requires the board of directors of an investment company to include "disinterested" persons. 15 U.S.C. § 80a-10(a). The Supreme Court has instructed that these persons serve as "independent watchdogs" who supply "an independent check upon the management." Burks v. Lasker, 441 U.S. 471, 484 (1979).

1. Legislative History

a. As originally enacted, the Act did not effectively monitor fee structures "negotiated" between funds and their investment advisers. Investment Company Amendments Act of 1969, S. Rep. No. 91-184 (1969), reprinted in 1970 U.S.C.C.A.N. 4897, 4901. Instead, the original Section 36 authorized the Securities and Exchange Commission (the "Commission") to bring an action against certain persons affiliated with investment companies for gross misconduct or gross abuse of trust within five years prior to when suit is filed. Pub. L. No. 768, ch. 686 § 36, 76th Cong., 3d Sess. (Aug. 22, 1940), 54 Stat. 841 (emphasis added).

b. As mutual funds experienced rapid growth in the 1950s and 1960s, investment advisers earned fees which did not necessarily reflect perceived economies of scale realized in managing larger funds. Securities & Exchange Commission, Public Policy Implications of Investment Company Growth, reprinted in H.R. Rep. No. 2237, 89th Cong., 2d Sess., 10-12 (1966). Congress determined that the unique structure of the mutual fund industry resulted in closer relationships between mutual funds and their investment advisers than those usually existing between other buyers and sellers of investment advisory services. Because of this closeness, "the forces of arm's-length bargaining [did] not work in the same manner in the mutual fund industry as they [did] in other sectors of

the American economy." S. Rep. No. 91-184, at 5, reprinted in 1970 U.S.C.C.A.N. 4897, 4901.

c. In 1970, Congress sought to address the problem by adding Section 36(b) to the Act, 15 U.S.C. § 80a-35(b), thereby imposing a fiduciary duty upon investment advisers in connection with their receipt of compensation.

- Section 36(b) is the only provision under the entire Act which expressly provides private citizens with a right of action. By responding to a specific problem in the mutual fund industry, Congress expressly sought to provide private citizens a right of action to remedy violations in limited circumstances. This is unlike any other provision of the Act.

- By its terms, Section 36(b) is limited to breaches of fiduciary duty involving an investment adviser's receipt of compensation. 15 U.S.C. § 80a-35(b). This provision does not on its face give plaintiffs the right to sue for alleged breaches of general fiduciary duties (compare with Section 36(a), discussed infra Section IV.B).

- Section 36(b) gives private litigants a short, one-year limitations period in which to bring suit. 15 U.S.C. § 80a-35(b). This is in direct contrast with the longer, five-year limitations period given the SEC for enforcement proceedings. E.g., Liaros v. Vaillant, No. 93 Civ. 2170, 1996 WL 88559, at *14 (S.D.N.Y. Mar. 1, 1996); In re ML-Lee Acquisition Fund II, L.P. & ML-Lee Acquisition Fund (Retirement Accounts) II, L.P. Sec. Litig., 848 F. Supp. 527, 542 (D. Del. 1994).

- Damages under Section 36(b) are limited to fees received by investment advisers within the prior year. 15 U.S.C. § 80a-35(b)(3). Only recipients of advisory compensation or other payments shall be liable for damages under Section 36(b). Id.

- Because Section 36(b) is "equitable" in nature, plaintiffs are not entitled to a jury trial. See Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 487 F. Supp. 999, 1001 (S.D.N.Y.), aff'd sub nom. In re Gartenberg, 636 F.2d 16 (2d Cir. 1980), cert. denied sub nom. Gartenberg v. Pollack, 451 U.S. 910 (1981); Kalish v. Franklin Advisers, Inc., 928 F.2d 590, 591 (2d Cir.), cert. denied, 502 U.S. 818 (1991); Schuyt v. Rowe Price Prime Reserve Fund, Inc., 663 F. Supp. 962 (S.D.N.Y.), aff'd, 835 F.2d 45, 46 (2d Cir. 1987), cert. denied, 485 U.S. 1034 (1988); Sivolella v. AXA Equitable Funds Mgmt. LLC, Nos. 11-4194, 13-312, 2013 WL 4096239 (D.N.J. July 3, 2013), adopted by, 2013 WL 4402331 (D.N.J. Aug. 15, 2013).

- For a comprehensive analysis of the legislative history and development of Section 36(b), see generally William P. Rogers & James N. Benedict, "Money Market Management Fees: How Much Is Too Much?," 57 N.Y.U. L. REV. 1059 (1982).

2. Initial Litigation—The Excessive Fee Cases

In connection with the increased popularity of money market funds in the 1980s, plaintiffs brought numerous claims under Section 36(b) alleging that investment advisers were charging these funds excessive management fees.[3]

a. Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 694 F.2d 923 (2d Cir. 1982), cert. denied sub nom. Andre v. Merrill Lynch Ready Assets Trust, 461 U.S. 906 (1983), was the first case to undertake a comprehensive analysis of the standards courts should apply when evaluating "excessive fee" claims under Section 36(b). In Gartenberg, two shareholders of the Merrill Lynch Ready Assets Trust money market fund brought a derivative action attacking the size of fees paid to the adviser as excessive, in breach of the adviser's fiduciary duty under Section 36(b). Plaintiffs did not claim that individual investors were not getting their money's worth, but rather, that the adviser, due to the size of the fund, was making too much money.

The District Court concluded that Congress was imprecise in delineating the fiduciary duty imposed by Section 36(b), but maintained that the standard is one of fairness. The court dismissed the complaint after applying a three-prong test that examined:

(1) whether the fee was in the range prevailing in the marketplace;

(2) whether the fee was sufficiently disclosed and the services satisfactorily performed; and

(3) whether the scope of the enterprise was adequately disclosed to directors and investors.

Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 528 F. Supp. 1038 (S.D.N.Y. 1981), aff'd, 694 F.2d 923 (2d Cir. 1982), cert. denied

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[3] Early cases under § 36(b) concerning advisory fees turned on whether plaintiffs, as shareholders in the funds, were required to make a demand on the fund directors before bringing suit. For years, courts uniformly held that such a demand was required under the traditional standards for derivative lawsuits under Rule 23.1. Weiss v. Temporary Inv. Fund, Inc., 692 F.2d 928 (3d Cir. 1982), vacated, 465 U.S. 1001, on remand, 730 F.2d 939 (3d Cir. 1984); Grossman v. Johnson, 674 F.2d 115 (1st Cir.), cert. denied sub nom. Grossman v. Fidelity Mun. Bond Fund, Inc., 459 U.S. 838 (1982).

In Fox v. Reich & Tang, Inc., 692 F.2d 250, 252 (2d Cir. 1982), aff'd sub nom. Daily Income Fund, Inc. v. Fox, 464 U.S. 523 (1984), the Court held that the demand requirement governing derivative actions brought by shareholders of a corporation does not apply to an action brought by an investment company shareholder under § 36(b) of the Act.

sub nom. Andre v. Merrill Lynch Ready Assets Trust, 461 U.S. 906 (1983).

The Second Circuit affirmed, holding that plaintiffs had failed to meet their burden of proving that the fees charged by the adviser were so excessive or unfair so as to amount to a breach of fiduciary duty within the meaning of Section 36(b). Gartenberg, 694 F.2d at 932. The court reviewed the "tortuous" legislative history of Section 36(b) and concluded that, to be guilty of a violation, the fee must be "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." Id. at 928.

The court identified six factors to be considered in determining whether fees charged by the investment adviser were disproportionate to the services rendered: (1) the nature and quality of the services provided to fund shareholders; (2) the profitability of the fund to the adviser-manager; (3) economies of scale of operating the fund as it grows larger; (4) comparative fee structures; (5) fallout benefits—i.e., indirect profits to the adviser attributable in some way to the existence of the fund; and (6) the independence and conscientiousness of the directors. Id.

b. Subsequent to Gartenberg, plaintiffs in the 1980s were generally unsuccessful in pursuing "excessive fee" claims under Section 36(b). See, e.g., Krinsk v. Fund Asset Mgmt., Inc., 875 F.2d 404, 409 (2d Cir.), cert. denied, 493 U.S. 919 (1989); Schuyt v. Rowe Price Prime Reserve Fund, Inc., 663 F. Supp. 962 (S.D.N.Y.), aff'd, 835 F.2d 45 (2d Cir. 1987), cert. denied, 485 U.S. 1034 (1988). See generally James N. Benedict, Mark Holland & Barry W. Rashkover, "Developments in Management Fee Litigation," Rev. of Sec. & Commodities Reg., Vol. 22, No. 15 (Sept. 13, 1989).

B. More Recent Litigation Involving Section 36(b)

Courts have issued numerous decisions involving Section 36(b) since the mutual fund industry scandal broke in 2003. These cases fall into roughly three categories: (1) "pure" excessive management fee actions under Section 36(b); (2) "manager of managers" actions where plaintiffs attack the fee structure of mutual funds that utilize sub-advisers; and (3) former revenue sharing cases repleaded as pure excessive management fee cases.

1. "Pure" Excessive Management Fee Cases

There are several of the so-called "pure" excessive management fee cases currently pending in United States District Courts throughout the nation. Most of these actions were brought by the same plaintiffs' counsel and contained, at the outset, nearly identical allegations. There have been numerous recent decisions in

this category of cases, most notably the Supreme Court's landmark decision in Jones, et al. v. Harris Associates, L.P.

a. Summary Judgment

(1) Following extensive fact and expert discovery, the parties in Jones v. Harris Assoc. L.P., No. 04 C 8305, 2007 WL 627640 (N.D. Ill. Feb. 27, 2007) cross-moved for summary judgment. Plaintiffs' argument in support of their motion focused "on conduct of parties other than Harris or actions of Harris other than receipt of compensation." Instead, plaintiffs claimed that the management agreements were invalid, rendering the associated fees charged thereunder "excessive." According to plaintiffs, the management agreements were invalid because: (1) one trustee "received deferred compensation from Harris, rendering him an interested party in Harris and making him ineligible to vote on approval of any fee agreements"; (2) the trustees' social and professional relationships with fund management precluded them from exercising "independent judgment in assessing the fees"; and (3) Harris failed to disclose one trustee's compensation and his relationships with other members of the board in relevant public filings. Id. at *5. The court disagreed. In rejecting plaintiffs' arguments, the court held that even if one of the purportedly "independent" trustees was deemed to be, in fact, "affiliated" with the adviser, the overwhelming majority of the remaining members of the Board that approved the subject fees were "independent." Second, the court found that plaintiffs' argument relating to the trustees' business and social relationships with fund management were insufficient to render them "affiliated" with the defendant, holding that plaintiffs failed to demonstrate requisite control of the trustees and a corresponding effect on shareholder interests. Finally, the court held that defendant's purported failure to disclose deferred compensation allegedly remitted to one of the funds' trustee was outside the scope of Section 36(b), finding that "[t]o sweep this conduct into the ambit of § 36(b) would directly contradict the universal view that the fiduciary duty it sets out is both narrow and limited." Id. at *6. Accordingly, the court denied plaintiffs' motion for summary judgment.

The court then turned to defendant's motion for summary judgment. Defendant argued that summary judgment was warranted because: (1) the fees at issue were in line with those charged to substantially similar funds in other fund

complexes; (2) the trustees were provided with information relating to each of the subject funds and the trustees approved the fee schedules; (3) the fee schedules included breakpoints that resulted, at least in part, through negotiation efforts by the trustees; and (4) the funds at issue performed relatively well during the relevant time period. See Jones, 2007 WL 627640, at *8. The court began its analysis by discussing the appropriate standard by which claims brought pursuant to Section 36(b) should be viewed. After briefly reviewing the Seventh Circuit's discussion of the issue in Green v. Nuveen Advisory Corp., 295 F.3d 738 (7th Cir. 2002), the court adopted the applicable framework set forth in Gartenberg. Turning its attention to defendant's first argument, the court noted that any comparison of fees required that it consider not only those fees charged to other funds within other complexes, but also those fees charged to defendant's institutional clients. The court nevertheless concluded that an examination of the fees charged to other mutual funds and institutional clients evidenced that the fees at issue fell within this range, "thus preventing a conclusion that the amount of fees indicates that self-dealing was afoot." Jones, 2007 WL 627640, at *8. Citing its previous discussion rejecting plaintiffs' motion for summary judgment, the court agreed with the defendant's second argument in support of summary judgment, concluding that "[t]he evidence the parties have provided indicate that the board as a whole was operating without any conflict that would prevent it from engaging in arm's-length negotiations with [the defendant]." Id. With respect to defendant's third point, the court found that, although breakpoints could have been set at a lower level, they nevertheless were comparable to the fee structures adopted by other mutual funds, providing a reasonable inference that such breakpoints were the result of arm's-length negotiations. Finally, the court noted that the funds performed well during the relevant time period, rejecting plaintiffs' request that it consider performance outside of the one year look-back period. As a result, the court concluded that summary judgment in favor of the defendant was warranted, holding that "[w]hat matters is whether there is a fundamental disconnect between what the Funds paid and what the services were worth; on this score Plaintiffs have not set forth an issue of fact that, if resolved in their favor, could lead to a finding that [Defendant] had breached its § 36(b) duty." Id. at * 9.

Plaintiffs appealed the district court's decision granting summary judgment to the Seventh Circuit, which affirmed. See Jones v. Harris Assoc. L.P., 527 F.3d 627 (7th Cir. 2008). In doing so, the Seventh Circuit rejected the notion that Section 36(b) empowers courts to engage in price setting and, in affirming summary judgment, relied heavily on the effect of competition in the mutual fund industry and the ability of investors to "vote with their feet." In the court's view, Section 36(b)'s fiduciary duty requires full disclosure and honesty in the fee-negotiation process, but the level of fees is to be established by competitive forces in the market. In so holding, the court explicitly rejected the Second Circuit's approach to the issue, as set forth in Gartenberg. Instead, the court noted, in pertinent part:

> "[J]ust 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 . . . . Having had another chance to study this question, we now disapprove of the Gartenberg approach. A fiduciary duty differs from rate regulation. A fiduciary must make full disclosure and play no tricks but is not subject to a cap on compensation. 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."

Id. at 632. The court also rejected plaintiffs' arguments based on comparisons to fees for institutional products, holding that such comparisons are invalid in light of differences in the management and servicing of those products. Specifically, the court found that:

> "Different clients call for different commitments of time. Pension funds have low (and predictable) turnover of assets. Mutual funds may grow or shrink quickly and must hold some assets in high-liquidity instruments to facilitate redemptions. This complicates an adviser's task. Joint costs likewise make it hard to draw inferences from fee levels. Some tasks in research, valuation, and portfolio design will have benefits for several clients. In competition those joint costs are apportioned among paying customers according to their elasticity of demand, not according to any rule of equal treatment."

Id. at 634-35. Accordingly, the Seventh Circuit affirmed dismissal of plaintiffs' complaint.

Following the Seventh Circuit's affirmance, plaintiffs moved for rehearing en banc. Although the court summarily rejected plaintiffs' motion, a group of five judges filed a dissenting opinion that argued that competition cannot be counted on to solve the problem of excessive mutual fund fees and suggested that fees for institutional products may be a valid benchmark. See Jones v. Harris Assocs. L.P., 537 F.3d 728, 730 (7th Cir. 2008). Specifically, the dissenters cited favorably to a study published by a professor at Northwestern University, which stated that an increasing amount of cronyism between agents in the mutual fund industry lead to increased fees that were borne by shareholders. See id. at 730-31 (citing Camelia M. Kuhnen, "Social Networks, Corporate Governance and Contracting in the Mutual Fund Industry" (Mar. 1, 2007), available at http:// ssrn. com/ abstract= 849705).

Additionally, the dissenters questioned the panel's reasoning in dismissing comparisons between the fees Harris Associates charged to its retail mutual funds and those charged to its institutional clients. The dissenters found that "[t]he panel opinion throws out some suggestions on why this difference may be justified, but the suggestions are offered purely as speculation, rather than anything having an evidentiary or empirical basis." Jones, 537 F.3d at 731. Instead, the dissenters cited favorably to a study by economists John Freeman and Stewart Brown, who found that:

> "[T]he chief reason for substantial advisory fee level differences between equity pension fund portfolio managers and equity mutual fund portfolio managers is that advisory fees in the pension field are subject to a marketplace where arm's-length bargaining occurs. As a rule, [mutual] fund shareholders neither benefit from arm's-length bargaining nor from prices that approximate those that arm's-length bargaining would yield were it the norm."

Id. at 731-32 (citing John P. Freeman & Stewart L. Brown, "Mutual Fund Advisory Fees: The Cost of Conflicts of Interest," 26 J. Corp. L. 609, 634 (2001)).

The dissenters also expressed dissatisfaction with the panel's formulation of the standard of liability for 36(b) actions; i.e., that the fees must be "so unusual that a court will infer that deceit must have occurred." Id. at 732 (citing Jones, 527 F.3d at 632). In particular, the dissenters found that the "so unusual" standard wrongly emphasized comparing the adviser's fees to those charged by other mutual fund advisers; but that the "governance structure that enables mutual fund advisers to charge exorbitant fees is industry-wide, so the panel's comparability approach would if widely followed allow those fees to become the industry's floor." Id.

Arguably, the dissenters' main contention with the panel's opinion may have been more procedural than substantive. The dissenters admitted that "[t]he outcome of this case may be correct", however, they took issue with the panel's failure to circulate its opinion to the full court prior to its publication, as is the practice with decisions that create circuit splits. Id. The dissenters found that "the creation of a circuit split, the importance of the issue to the mutual fund industry, and the one-sided character of the panel's analysis warrant our hearing the case en banc." Id. at 732-33.

Seizing upon the language of the five dissenting judges, counsel for the plaintiffs subsequently petitioned the Supreme Court for review of the case. On March 9, 2009, the Supreme Court granted plaintiffs' petition for certiorari. See Jones v. Harris Assoc. L.P., 129 S. Ct. 1579 (2009). On March 30, 2010, in a landmark decision, the Court reversed the Seventh Circuit's decision and, in doing so, unanimously determined that the Second Circuit's decision in Gartenberg appropriately harmonized both the plain language of the statute and Congressional intent, and represented the appropriate standard under Section 36(b). See Jones v. Harris Assocs. L.P., 130 S. Ct. 1418 (2010).

Justice Samuel Alito, writing for a unanimous Court, began the decision by reviewing the historical underpinnings of the statute and its corresponding amendments, noting that Section 36(b) was born out of "problems relating to the independence of investment company boards and the compensation received by investment advisers." See id. at 1422 (internal citations omitted). According to the Court, the "fiduciary duty" standard contained in Section 36(b) represented a "delicate compromise" between protecting

shareholder interest and eschewing any formal rate-making authority to be vested with the SEC. See id. at 1423.

The Court then addressed its attention to the meaning of Section 36(b)'s use of the term "fiduciary duty," noting first that in the intervening years since Congress passed the statute, both the judiciary and the SEC repeatedly and consistently have interpreted that language in a manner substantially similar to that adopted by the Second Circuit in Gartenberg. The Court relied on its decision in Pepper v. Litton, 308 U.S. 295 (1939), an "analogous" bankruptcy case wherein the Court looked to trust law, to inform Section 36(b)'s "fiduciary duty" phraseology. In Pepper, the Court found that:

> [t]he essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain. If it does not, equity will set it aside.

See Jones, 130 S. Ct. at 1427 (quoting Pepper, 308 U.S. at 306-07).

According to the Court in Jones, "this formulation expresses the meaning of the phrase 'fiduciary duty' in [Section] 36(b)," and the Gartenberg approach as set forth by the Second Circuit "fully incorporates this understanding of the fiduciary duty set out in Pepper and reflects [Section] 36(b)(1)'s imposition of the burden on the plaintiff." Id. Moreover, the formulation under Gartenberg correctly insists that "all relevant circumstances be taken into account" and properly "uses the range of fees that might result from arm's-length bargaining as the benchmark for reviewing challenged fees." Id.

The Court also noted that the approach set forth in Gartenberg properly reflects Section 36(b)'s place in the overall statutory scheme of the Act, particularly in connection with "its relationship to the other protections that the Act affords investors." Id. According to the Court, scrutiny of investment adviser compensation by both a fully informed and independent board and shareholder suits constitute separate and mutually reinforcing mechanisms for controlling adviser conflicts of interests. See id. at 1427-28. With respect to the independent fund directors, the Act instructs that a measure of deference to a board's judgment may be appropriate in some instances, but that

the measure of deference is dependent on the particular circumstances of the case. See id. at 1428. According to the Court, Gartenberg "heeds these precepts." Id.

Although both of the parties in the case endorsed the basic Gartenberg approach, the Court found several fundamental and material disagreements that warranted further discussion. The first of these disagreements centered on whether (and when) a comparison of the fees charged to an adviser's institutional clients is appropriate when assessing the fees charged to retail mutual funds. Finding that the Act requires consideration of all "relevant factors," the Court refused to embrace a bright-line rule and instead instructed courts to "give such comparisons the weight that they merit in light of the similarities and differences between the services that the clients in question require" and cautioned courts to "be wary of inapt comparisons." Id. In doing so, the Court specifically dismissed concerns that such comparisons would "doom any fund to trial," noting that "plaintiffs bear the burden in showing that fees are beyond the range of arm's-length bargaining," and "[o]nly where plaintiffs have shown a large disparity in fees that cannot be explained by the different services in addition to other evidence that the fee is outside the arm's-length range will trial be appropriate." Id. at 1429 n.8. In addition, the Court cautioned courts from relying too heavily on comparisons with fees charged to mutual funds by other fund advisers, as such comparisons may not necessarily be appropriate given that other fund adviser fees may themselves suffer from a lack of arm's-length negotiation. See Jones, 130 S. Ct. at 1429.

Finally, the Court found that Section 36(b) requires a court's evaluation of an investment adviser's fiduciary duty to take into account "both procedure and substance." See id. (internal citations omitted). The Court noted that "[w]here a board's process for negotiating and reviewing investment-adviser compensation is robust, a reviewing court should afford commensurate deference to the outcome of the bargaining process." Id. (citations omitted). As a result, "if the disinterested directors considered the *relevant factors*, their decision to approve a particular fee agreement is entitled to considerable weight, even if a court might weigh the factors differently." Id. (emphasis

added).[4] The Court noted that instances may arise when a board's process was somehow deficient or when the adviser withholds important information. In such circumstances, a reviewing court "must take a more rigorous look at the outcome." Id. at 1430. In so holding, the Court cautioned that the fiduciary duty standard under Section 36(b) "does not call for judicial second-guessing of informed board decisions," nor does it suggest that "a court may supplant the judgment of disinterested directors apprised of all of the relevant information, without additional evidence that the fee exceeds the arm's-length range. See id.

As a result, the Court concluded that the Seventh Circuit, by focusing almost exclusively on the element of disclosure, erred, and vacated and remanded the decision for further proceedings. See id. at 1430-31.

(2) In Gallus v. Ameriprise Fin., Inc., 497 F. Supp. 2d 974 (D. Minn. 2007), plaintiffs asserted claims under Sections 12(b) and 36(b) of the Act, claiming that the fees charged to several funds within the American Express-branded family of funds were "excessive." At the conclusion of fact discovery, defendants moved for summary judgment, arguing that there was no genuine issue of material fact based on the evidence relating to the Gartenberg factors regarding whether the fees could not have been the product of arm's-length bargaining under Section 36(b). After setting forth the applicable standard set forth in Gartenberg, the court concluded that there are was no genuine issue of material fact regarding whether the fee 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. See Gallus, 497 F. Supp. 2d at 984.

With respect to the nature and quality of services provided by the adviser to the funds, the court found that plaintiffs failed to establish a link between alleged misconduct that resulted in several regulatory settlements and the value of services paid for by the challenged fees, and that plaintiffs' characterization of the "undisputed performance figures as

[4] In so holding, the Court embraced the applicability of the Gartenberg factors and further solidified the almost 30 years of jurisprudence that has developed since the Second Circuit's decision was first rendered. See Jones, 130 S. Ct. at 1429-30; see also id. at 1425-26 & n.5 (listing relevant Gartenberg factors).

'poor'," standing alone, did not create a genuine issue of material fact. Id. at 980. Next, the court analyzed the profitability of the funds to the adviser, and concluded that plaintiffs' mere assertions that the detailed reports provided by the adviser to the funds were improper because of the cost allocation methodology was insufficient to create a genuine issue of material fact. Id. at 980-81. Furthermore, the court found that the board was provided with detailed reports that expressly addressed certain so-called "fall-out" benefits when negotiating the fees with the adviser, and that plaintiffs' assertions that the profitability or cost data with respect to institutional business constituted a fall-out benefit did not create an issue of material fact. Id. at 980. The court also held that the breakpoints in the subject funds' fee schedules, as well as the fee adjustments based on fund performance, served to share the benefit of economies of scale, and rejected plaintiffs' claim that defendants' should have shared more with the funds based merely on expert testimony that failed to identify what amount of cost savings would have been appropriate. Id. at 981-82. The court then analyzed plaintiffs' contention that the fees charged to non-mutual funds was somehow relevant for determining the excessiveness of the fees charged to mutual funds, concluding that such a comparison was expressly rejected by the Second Circuit in Gartenberg. The court further concluded that, even if such a comparison was somehow relevant, the plaintiffs failed to demonstrate how the services provided to the different types of funds were comparable and that, in any event, the Board had, in fact, been provided with such data. See Gallus, 497 F. Supp. 2d at 982-83. Finally, the court found that the plaintiffs had failed to adduce any evidence that the Board members were not independent and qualified; nor did plaintiffs dispute that the Board met regularly, played an active role in the contract negotiation process, and sought the advice and counsel of third-party consultants. Id. at 983. As a result, the court concluded that summary judgment on plaintiffs' Section 36(b) claim was warranted. Id. at 983-84.

Turning to the remaining claim under Section 12(b), the court held that: (1) plaintiffs' assertion that existing shareholders received "absolutely 'no material benefit'" from the distribution fees was "without merit," noting that "approximately 85% of Defendants' 12b-1 distribution fees were paid for services to existing shareholders and not to marketing the Funds to new shareholders"; and (2) that the

evidence established that the Board had, in fact, considered the benefits of the services provided pursuant to the distribution fees. The court dismissed plaintiffs' claim brought pursuant to Section 12(b). Id. at 985.

Plaintiffs appealed the district court's decision to the Eighth Circuit. See Gallus v. Ameriprise Fin., Inc., 561 F.3d 816 (8th Cir. 2009). The Eight Circuit began its substantive analysis by, inter alia, detailing the Second Circuit's decision in Gartenberg and comparing it to the Seventh Circuit's decision in Jones. See id. at 822. Rejecting the Seventh Circuit's reasoning in Jones, the Gallus court concluded that Gartenberg "provide[s] a useful framework for resolving claims of excessive fees," but also found that Section 36(b) provides for a basis of liability independent of, and wholly apart from, any excessiveness of the fee. The Eighth Circuit concluded that "[w]e believe that the proper approach to § 36(b) is one that looks to *both* the adviser's conduct during negotiation and the end result" and that "[u]nscrupulous behavior *with respect to either* can constitute a breach of fiduciary duty." Id. at 823 (emphasis added). Thus, the court noted that an adviser's conduct in connection with the board's review and approval process may serve as a violation of Section 36(b) even though the fee is in line with those charged by comparable funds and "passed muster under the Gartenberg standard." Id.

In addition to this determination that Section 36(b) provides for an "independent" basis of liability, the Eighth Circuit held that the lower court "erred in rejecting a comparison between the fees charged to Ameriprise's institutional clients and its mutual fund clients." Id. at 823. In so holding, the Eighth Circuit refused to embrace a bright-line rule, but noted that "the argument for comparing mutual fund advisory fees with the fees charged to institutional accounts is particularly strong in this case because the investment advice may have been essentially the same for both accounts." Id. at 824. As a result, the Eighth Circuit determined that a dispute between the experts retained by the parties here about whether the adviser "purposefully omitted, disguised, or obfuscated information that it presented to the Board about the fee discrepancy between different types of clients" raised a question of material fact precluding the grant of summary judgment in favor of defendants. Id.

Counsel for defendants subsequently petitioned the Supreme Court for review of the case. See No. 09-163, Petition for Cert. Filed, 78 USLW 3083 (U.S. Aug. 6, 2009). On April 5, 2010, the Supreme Court granted the defendants' petition, vacated the lower court judgment, and remanded the case for further consideration in light of the Court's decision in Jones v. Harris Associates L.P., 130 S. Ct. 1418 (2010). The Eighth Circuit's decision was very difficult to reconcile with the Supreme Court's holdings in Jones that Section 36(b) is "sharply focused on whether the fees themselves were excessive," and that instances of non-disclosure (i.e., when the adviser withholds important information from the board) go only to the weight given to the board's approval of the fees. Jones, 130 S. Ct. at 1430.

On remand, the district court reinstated its Order granting summary judgment and re-entered judgment in favor of the defendants. See Gallus v. American Exp. Fin. Corp., Civ. No. 04-4498, 2010 WL 5137419, at *1 (D. Minn. Dec. 10, 2010). The court held that "[i]n Jones, the Supreme Court adopted the Gartenberg framework and reasoning that this Court used in reaching its summary judgment opinion. And, in its order reversing this Court, the Eighth Circuit specifically noted that this Court properly applied the Gartenberg factors." Gallus, 2010 WL 5137419, at *2.

Plaintiffs appealed the district court's decision, but the Eighth Circuit affirmed. See Gallus v. Ameriprise Fin., Inc., 675 F.3d 1173 (8th Cir. 2012). The Eighth Circuit began its analysis by noting that "Jones has altered the way in which we determine whether an adviser has breached its fiduciary duty under § 36(b). In our previous decision, we held that the proper approach to § 36(b) is one that looks to both the adviser's conduct during negotiation and the end result . . . but after Jones, process-based failure alone does not constitute an independent violation of § 36(b). Instead, we have been instructed that § 36(b) is sharply focused on the question of whether the fees themselves were excessive." Id. at 1179 (internal citations omitted).

The Eighth Circuit stated that the "fee-negotiation process remains crucially important, as it allows the court to determine the amount of deference to give the board's decision to approve the fee." Id. The court then noted that the directors received information on the services provided to the funds, the adviser's profit from the funds, and on institutional fees (at the board's request). The Eighth

Circuit decreased the amount of deference accorded to the board's judgment, however, because the directors placed too much significance on the fees charged by the funds' competitors, which "like those challenged, may not be the product of negotiations conducted at arm's length." Id. (quoting Jones, 130 S. Ct. at 1429).

The Eighth Circuit then rejected plaintiffs' claims with regard to the fees charged to Ameriprise's institutional clients. Specifically, the Eighth Circuit noted that "[a]lthough the disparity in fees charged to Ameriprise's different clients is likely relevant to whether the fees fall within the arm's length range, the plaintiffs have failed to set forth the additional evidence required to survive summary judgment." Gallus, 675 F.3d at 1180-81 (internal citations omitted).

The Eighth Circuit next considered plaintiffs' argument that the alleged flaws in the fee-negotiation process constituted additional evidence that the fees violated Section 36(b). The Eighth Circuit rejected this argument, and noted that "[w]e do not read Jones to allow a deficient process to be the additional evidence required to survive summary judgment . . . because the opinion's language again focuses on evidence that the fee is outside the arm's length range." Id. at 1181.

Finally, the Eighth Circuit rejected plaintiffs' contentions that the district court's "rigorous" review was not "rigorous" enough, and that an adviser runs afoul of Rule 12b-1 if it benefits from a Rule 12b-1 fee. Instead, the Eighth Circuit held that an adviser only violates Rule 12b-1 if such a fee is "outside the range of what would have been negotiated at arm's-length in the light of all of the surrounding circumstances." Id. at 1182 (internal citations omitted).

(3) In Bennett v. Fidelity Management & Research Co., C.A. Nos. 04-11651, 04-11756, 2011 WL 98837 (D. Mass. Jan. 10, 2011), the court issued a decision after briefing and hearing on the defendants' motion for summary judgment in which it held that "[a]fter Jones, the ultimate standard of liability under § 36(b) is whether an investment adviser charged a fee that was so disproportionately large that it bore no reasonable relationship to the services rendered and could not have been the product of arm's length bargaining." Id. at *1 (citing Jones, 130 S. Ct. at 1426;

Gartenberg, 694 F.2d at 928). The court thereafter ordered plaintiffs to submit supplemental briefing identifying "the evidence they rely upon to place in genuine dispute each applicable Gartenberg factor" and "why those disputed factors would, if decided in plaintiffs' favor, be sufficient to persuade a reasonable finder of fact that the challenged fees were so disproportionately large that they bore no reasonable relationship to the services rendered and could not have been the product of arm's length bargaining." Bennett, 2010 WL 98837, at *2. Defendants were ordered to explain in response why the plaintiffs are not entitled to prevail. Id. Plaintiffs subsequently stipulated to dismiss this case with prejudice. See Bennett v. Fidelity Mgmt. & Research Co., No. 04-11651, Stipulation of Dismissal (D. Mass. Jan. 27, 2012).

b. Motions To Dismiss

(1) In Turner v. Davis Select Advisers LP, No. 08-CV-421, slip op. (D. Ariz. June 1, 2011), plaintiff asserted causes of action under Sections 36(b), 47, and 48(a) of the Act. Plaintiff alleged that the adviser to and distributor of the Davis New York Venture Fund received disproportionately large Rule 12b-1 fees, and the adviser received excessively disproportionate advisory fees, in violation of Section 36(b). Plaintiff also asserted control person liability against the adviser, and contended that the advisory and distribution contracts should be voided under Section 36(b).

After concluding that plaintiff did have standing to assert the claims (slip op. at 6-9); that the amended complaint related back to the date of filing of the original complaint (slip op. at 9-10); and that the damages period under Section 36(b) is not confined solely to the one year period prior to filing of the complaint (slip op. at 11-12), the court performed a Gartenberg factor-by-factor analysis of the complaint. The court concluded that "[w]hile Plaintiff is correct that '[t]he Amended Complaint Sufficiently Articulates the Gartenberg Factors,' Plaintiff's allegations largely consist of general conclusions, not facts, and Plaintiff does not explain how any of the facts alleged show that a particular fee 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.'" Slip op. at 13 (quoting Gartenberg, 694 F.2d at 928).

Having concluded that plaintiff failed to state a claim under Section 36(b) against either the adviser or the distributor, the court also dismissed the claim for control person liability under Section 48(a). Slip op. at 19. The court also concluded that Plaintiff was not standing in the shoes of the fund and was not a party to the contracts which he sought to void. As such, the court dismissed plaintiff's Section 47(b) claim. Slip op. at 17-19. Plaintiff has appealed the court's decision to the Ninth Circuit.

(2) In Sins v. Janus Capital Mgmt., LLC, No. 04-cv-1647, 2006 WL 3746130 (D. Colo. Dec. 15, 2006), plaintiffs, shareholders of funds within the Janus-branded family of funds, asserted derivative claims under Section 36(b) of the Act and alleged that the defendant breached its fiduciary duties by providing similar services to institutional clients for substantially lower fees and that defendants failed to pass on the benefits of economies of scale. Defendants moved to dismiss, arguing that plaintiffs' allegations were insufficient to state a claim under Section 36(b) because they were based on observations and criticisms of the mutual fund industry generally and conclusory statements purportedly based upon "information and belief, and did not relate to the disproportionality of the fees at issue. See id. at *2.

The court agreed that plaintiffs' generalized allegations, standing alone, were insufficient to state a cause of action under Section 36(b), and noted that it was both "concerned" and "troubled" by plaintiffs' allegations made on purported "information and belief," finding that such allegations were identical to those in other complaints in unrelated cases. Nevertheless, the court found that the complaint contained facts sufficient to state a claim upon which relief may be granted, and denied defendants' motion. After reviewing the Gartenberg factors and noting that the Tenth Circuit has not expressly adopted those factors, the court analyzed several of the Gartenberg factors in turn, and concluded that plaintiffs' allegations were sufficient to withstand dismissal at the initial pleading stage. See Sins, 2006 WL 3746130, at *3-4.

(3) In Hunt v. Invesco Funds Group, Inc., No. H-04-2555, 2006 WL 1581846 (S.D. Tex. June 5, 2006), plaintiffs asserted derivative claims under Section 36(b) of the Act on behalf of eight different mutual funds in the AIM-branded family of funds. Plaintiffs alleged that the benefits

resulting from the marked increase in fund assets were improperly retained by defendants, rendering their advisory and distribution fees "excessive" in violation of the fiduciary duties imposed upon them by Section 36(b). Defendants moved to dismiss, arguing: (1) that plaintiffs failed to allege sufficient facts specific to each of the eight funds at issue, as required by Gartenberg; and (2) even if some allegations were sufficiently specific, they were based on factual and other deficiencies.

The court disagreed and sustained plaintiffs' amended complaint, finding that the allegations as pled were "sufficient to allege a disproportionality between the fees that Defendants charged each of the funds at issue and the services that Defendants provided to the funds." Id. at *2. Analyzing several Gartenberg factors in turn, the court found that the amended complaint sufficiently set forth allegations pertaining to: (1) the amounts and types of fees charged by defendants for each of the eight funds; (2) the nature and quality of services provided to the funds, both in general and specific terms; (3) the existence of scale economies and the failure of defendants to pass on the resulting benefits to fund shareholders; and (4) the independence and conscientiousness of the funds' trustees. Furthermore, the court pointed out that plaintiffs advisory fee comparisons were sufficient to survive a motion to dismiss, noting that the amended complaint included facts comparing the advisory fees for each of the funds at issue with those "fees charged for equivalent advisory services," including institutional pension accounts managed by defendants as well as "average advisory fees charged for [sic] peer mutual funds." Id. at *2-5.

Finally, the court rejected defendants argument that plaintiffs allegations were "based upon demonstrably false and contradictory premises, which cannot sustain plaintiffs' claims," noting that defendants had "failed to demonstrate that the allegations are contradictory or not well-pled" and were sufficient to state a claim under Section 36(b). Id. at *5.

Following the court's decision, plaintiffs' agreed to dismiss their complaint with prejudice and without costs. See Hunt v. Invesco Funds Group, Inc., No. H-04-2555, slip op. (S.D. Tex. Jan. 29, 2007).

(4) In Dumond v. Massachusetts Fin. Servs. Co., No. Civ. A. 04-11458, 2006 WL 149038 (D. Mass. Jan. 19, 2006), plaintiffs, shareholders of funds within the Massachusetts Financial Services (MFS) fund complex, brought suit under Section 36(b) of the Act. Plaintiffs alleged that defendants failed to pass on the benefits of economies of scale, had charged excessive distribution fees, had provided similar services to institutional clients for substantially lower fees, and paid excessive commissions to broker-dealers in exchange for soft dollars.

On motion to dismiss, defendants argued that plaintiffs did not plead factual allegations sufficient to state a claim under Section 36(b). After reviewing the Gartenberg factors and noting that the First Circuit has not expressly adopted those factors, Judge O'Toole opined that Gartenberg does not establish a heightened pleading standard for Section 36(b) claims and that the plaintiffs' failure to plead facts that specifically address the Gartenberg factors was not in itself a ground for dismissal. The court held that plaintiffs' allegations were factual, not merely conclusory. The court held that although certain cases could be read as requiring a higher level of factual pleading under Section 36(b) (see Krantz v. Prudential Invs. Fund Mgmt., 305 F.3d 140 (3d Cir. 2002), cert. denied, 537 U.S. 1113 (2003); Migdal v. Rowe Price-Fleming Int'l, 248 F.3d 321 (4th Cir. 2001); Yampolsky v. Morgan Stanley Inv. Advisers Inc., No. 03 Civ. 5710, 2004 WL 1065533 (S.D.N.Y. May 12, 2004)), they were not binding precedent in the District of Massachusetts and were inconsistent with the applicable standard under Fed. R. Civ. P. 8. Furthermore, said the court, the instant action presented a different set of alleged deficiencies than those that led the courts to dismissal in the other cases. Dumond, 2006 WL 149038, at *2-3.

Following Judge O'Toole's decision denying defendants' motion to dismiss, defendants filed a motion for a protective order in an effort to secure a decision: (1) declaring that the damages period applicable to a Section 36(b) claim is limited to only the one year period prior to the filing of the complaint; and (2) prohibiting plaintiffs from seeking discovery after the relevant damages period except to the extent that such documents created after the applicable period contain or reflect responsive information relating to the at-issue period. See Dumond v. Massachusetts Fin. Servs. Co., No. Civ. A. 04-11458, 2007

WL 602589, at *1 (D. Mass. Feb. 22, 2007). Plaintiffs opposed defendants' motion, arguing that the period for which damages may be awarded under Section 36(b) begins one year before the filing of the complaint and continues until the complaint is fully adjudicated and that, even if the court were to limit damages to those accruing within the one year period prior to the commencement of the lawsuit, discovery should not necessarily be limited to events occurring within that limited period. See id. at *1. In support of their position, defendants cited numerous cases, including the Supreme Court's decision in Daily Income Fund v. Fox, 464 U.S. 523, 526 n.2 (1984). After briefly addressing each case in turn, the court noted that, with the sole exception of a lone order by a magistrate judge, "[i]n all of these cases, the courts were considering the effect of § 36(b)(3)'s backward-looking limitation, and not whether that section imposed a forward-looking one." Dumond, 2007 WL 602589, at *4. With respect to Daily Income, the court found that "the Court's brief reference to the damages period was casual dictum, not a controlling holding," and concluded that Section 36(b)(3) permits ongoing damages on a forward-looking basis. Dumond, 2007 WL 602589, at *5. Accordingly, the court denied defendants' motion for a protective order.[5]

(5) In Strigliabotti v. Franklin Resources, Inc., No. C 04-883, 2005 WL 645529 (N.D. Cal. Mar. 7, 2005), plaintiffs alleged that the advisory fees charged by defendants were higher than those for other funds for which defendants performed equivalent services and that distribution fees charged by the defendants were excessive, in violation of Sections 36(b) and 12(b). The court adopted the standard established in Gartenberg, and the six factors that federal courts have identified in applying that standard, and found that plaintiffs' alleged a disproportionate relationship between fees and services, that while assets had increased over time the nature of services rendered had not changed, and that defendants had retained excess profits resulting from economies of scale. Those allegations, the court held, were sufficient under Rule 8's liberal pleading standard.

[5] In a virtually identical "pure" excessive case brought against Putnam, also pending before Judge O'Toole, the court denied defendants' motion to stay a second action brought against Putnam and held that Section 36(b)(3)'s one year limitations period does not impose a forward-looking limitation on damages. See Vaughn v. Putnam Inv. Mgmt. LLC, No. 04-10988, 2007 WL 602596, at *5 (D. Mass. Feb. 22, 2007).

Id. at *3-4. The court found that "the complaint specifically describes the disproportionate relationship between [the] services and the fees charged according to the Gartenberg factors," and denied the motion to dismiss with respect to the Section 36(b) claims. Id. at *4. The court did, however, hold that "the gravamen of [the Section 36(b) and Section 12(b)] claims is breach of fiduciary duty, a claim expressly authorized under Section 36(b), and fully remediable through plaintiffs' Section 36(b) claim," and dismissed the claim under Section 12(b). Id. at *6. The court also dismissed two non-adviser defendants because they were not alleged to have received compensation within the meaning of Section 36(b). Id. at *5. See also Bahe v. Franklin/Templeton Distribs., Inc., No. 04-cv-11195 (D. Mass. Mar. 17, 2005) (holding at hearing on motion to dismiss that the factors delineated in Gartenberg and Krinsk, and possibly other relevant factors, provide the standard for determining whether a violation of Section 36(b) has occurred, and denying motion to dismiss).

Plaintiffs filed a Second Amended Complaint, making a few substantive changes in reaction to the court's decision on defendants' motion to dismiss. After some procedural maneuvering, defendants subsequently moved for judgment on the pleadings. See Strigliabotti v. Franklin Resources, Inc., 398 F. Supp. 2d 1094, 1096-97 (N.D. Cal. 2005). Defendants argued that plaintiffs' Sections 36(b) claims should be dismissed because plaintiffs did not plead any facts demonstrating that the fees charged to any specific fund were excessive in relation to any specific fund. Id. at 1097. According to defendants, "the Complaint simply contains a generalized attack on the Franklin Fund Complex, and that even if plaintiffs' allegations were true, they would not prove that the fees charged to any particular fund were excessive under Section 36(b)." Id. Defendants further argued that the Third Amended Complaint, like the previous complaints, failed to allege that two of the defendants (Franklin Resources, Inc. and Franklin Templeton Services, LLC) were "recipients" of compensation or payments as required by Section 36(b). Id.

Plaintiffs argued that the motion was an "improper 'second bite at the apple'" and that defendants' argument with respect to Section 36(b) was barred by the law of the case. The court agreed and held that the defendants' argument in the motion for judgment on the pleadings regarding

plaintiffs' Section 36(b) claims and defendants' argument in their motion to dismiss "rely on the same case law and advance the same general attack on plaintiffs' Section 36(b) claims" and that the latter argument was barred by the law of the case. Id. at 1098. The court also held that plaintiffs adequately alleged that Franklin Resources received compensation within the meaning of Section 36(b) and denied defendants' motion in that regard, but that plaintiffs failed to do so with respect to Franklin Templeton Services and thus granted the motion as to that defendant. Id. at 1098-99. The parties subsequently settled for an undisclosed amount.

(6) In Brever v. Federated Equity Mgmt. Co. of Pa., 233 F.R.D. 429 (W.D. Pa. 2005), plaintiffs alleged in a complaint originally filed in federal court in Florida on February 25, 2004, that defendants charged excessive fees and retained compensation for advisory services rendered without appropriate reductions for economies of scale in violation of defendants' fiduciary duty to a Federated fund under Section 36(b). Id. at 431. In March 2004, plaintiff sold his shares in the Federated fund at issue and divested himself of standing to maintain an action under Section 36(b). Id. Plaintiffs moved to file an amended complaint and substitute four plaintiffs for Brever as shareholders of the Federated fund. Id. at 431-32. The court granted plaintiffs' motion to amend "to the extent it seeks to add substitute plaintiffs to the litigation in order to pursue claims under the ICA utilizing the same theories of liability initially advanced by Brever." But the court limited the substitute plaintiffs' ability to recover damages in accordance with the mandate of Section 36(b)(3). Id. at 432. The court examined the history and text of Section 36(b) and held that Congress specifically limited a shareholder's ability to police and challenge recently awarded management agreements to one year. Id. at 432-33. "In effect, substitute plaintiffs seek to toll the statute of limitations essentially on the ground that a prior shareholder challenged previous fee arrangements but failed to see the challenge through to fruition. The statute contains no provision that suggests or implies that such an approach was contemplated by Congress or would be consistent with the statutory approach it ultimately adopted." Id. at 433-34. Nor, decided the court, was equitable tolling or the "relation back" doctrine applicable.

Id. at 434-35. The court limited plaintiffs' claim under Section 36(b) to one year prior to February 24, 2005.[6]

Plaintiffs thereafter filed a Consolidated Amended Complaint with "the phoenix emerging as a 'pure excessive fee' case under section 36(b) of the Investment Company Act of 1940" with regard to the Federated Kaufmann Fund. In re Federated Mutual Funds Excessive Fee Litig., No. 2:04cv352, 2009 WL 5821045, at *2 (W.D. Pa. Sept. 30, 2009) (quoting James N. Benedict, Sean M. Murphy, C. Neil Gray & Robert R. Miller, Recent Developments in Litigation Involving Mutual Funds and Investment Advisers, 1732 PLI/Corp 943, II(A) (Jan. 16, 2009)). Defendants moved to dismiss. Correctly anticipating the Supreme Court's recent decision in Jones, Judge Cercone declined to follow the Seventh Circuit's reasoning, and instead followed Gartenberg. See In re Federated, 2009 WL 5821045, at *2-3. Noting that plaintiffs set forth allegations that: (1) there were errors in the fund's Section 15(c) process; (2) "the services provided have not been of a quality or quantity that would justify the fee arrangement"; (3) the adviser, despite the fund's growth in size, did not offer breakpoints or otherwise appropriately share economies of scale; and (4) the fund's fee was excessive in comparison to other Federated funds, as well as other separately managed accounts, the court deemed plaintiffs' allegations sufficient to state a claim under Section 36(b). See id. at *8.

Thereafter, Federated moved for partial summary judgment on the damages period under Section 36(b). Defendants argued that Section 36(b)(3) limits any recovery to damages incurred during a short, one-year period—specifically, the year immediately preceding the filing of an action under the statute. This interpretation, defendants argued, is consistent with the Act's related requirement that a fund's advisory fee arrangement be approved on an annual basis by the fund's board of trustees, Congress' intent to avoid creating a vehicle for nuisance litigation

[6] See also Reaves v. Federated Inv., Inc., No. 2:05cv201, 2007 WL 709327, at *2 (W.D. Pa. Mar. 5, 2007) (granting defendants' motion to dismiss plaintiffs' claim under Section 36(b), holding that allegations that the subject fund's "investment adviser has benefited from the redemption fee[s] in question by obtaining a reduction in the Fund's annual operating expenses, which in turn reduces the total expenses that exceed the threshold at which the investment advisor has obligated itself to pay under an expense limitation" as clearly "beyond Section 36(b)'s purview").

against mutual fund investment advisers, and applicable case law. Plaintiffs contended that they were entitled to recover damages not only during the one-year look-back period established by Section 36(b)(3), but also for any period subsequent to their respective actions through trial and judgment.

The court denied Federated's motion, holding that "[t]he plain meaning of the statute does not support the interpretation by defendants" and "[i]f it is determined that the language of the statute is unambiguous, judicial inquiry ceases and the need to explore congressional intent and legislative history is obviated." In re Federated Mutual Funds Excessive Fee Litig., No. 2:04cv352, 2011 WL 846068, at *1 (W.D. Pa. Mar. 8, 2011). "Contrary to defendants' view, the statute's silence as to post-filing damages cannot be read to preclude recovery. While the test of § 36(b)(3) unequivocally bars the recovery of any damages incurred prior to the one-year pre-filing window, the text does not explicitly or implicitly preclude the recovery of damages incurred after the filing of suit." Id. at *2. The court concluded that the "overwhelming majority" of courts that have considered the matter reached the same conclusion. Id.

(7) In Gallus v. Amer. Express Fin. Corp., 370 F. Supp. 2d 862 (D. Minn. 2005), the court found plaintiffs' allegations under Section 36(b) sufficient to survive a motion to dismiss, but "by only the narrowest of margins." Id. at 867. The court examined plaintiffs' allegations in the context of the Gartenberg standard–"[t]he seminal case on Section 36(b)"–and the six factors developed under that standard. The court found "compelling Plaintiffs' allegations regarding the profitability of the Funds, the economies of scale generated by the Funds, and the 'fall-out' benefits obtained by [the adviser]," but questioned "whether Plaintiffs even have a good faith basis" for their allegations with respect to the other Gartenberg factors. Id. Nonetheless, the court denied defendants' motion to dismiss the claims under Section 36(b), subject to reconsideration after limited, "staged" discovery designed to "allay the Court's concerns." Id. Similar to the court in Strigliabotti, the court questioned the existence of a private right of action under Section 12(b), but held that plaintiffs had an adequate remedy for their claim under Section 36(b) and, thus, did not reach the private right of action issue. Id. at 868.

As previously discussed, supra, the Eighth Circuit affirmed a grant of summary judgment for defendants.

(8) In Jones v. Harris Assocs., L.P., No. 04 C 8305, 2005 WL 831301 (N.D. Ill. Apr. 7, 2005), the court did not explicitly list the six Gartenberg factors, but did acknowledge that cases examining the nature of the private right of action created by Section 36(b) "have concluded that the duty is breached only when the fee imposed is so disproportionately excessive when compared to the services for which it pays that it could not have been achieved through the arm's-length bargaining expected from the fiduciary." Id. at *2 (citing Gartenberg, 694 F.2d at 928). The court found that allegations that the fund complex paid forty three times more in 2003 than it had ten years earlier for identical services from the adviser, and that other clients receive like services from the adviser at significantly lower rates, were sufficient to survive defendants' challenge under Rule 12(b)(6). Id.

As previously discussed, supra, following extensive fact and expert discovery, the parties cross-moved for summary judgment. While summary judgment was thereafter granted for defendants, the case was ultimately remanded following the Supreme Court's decision.

(9) The court in another decision, Yampolsky v. Morgan Stanley Inv. Advisors Inc., Nos. 03 Civ. 5710, 03 Civ. 5896, 2004 WL 1065533 (S.D.N.Y. May 12, 2004), dismissed the plaintiffs' complaints for failure to plead facts to support the Gartenberg factors. The court noted that in order to make the determination as to whether the adviser is charging a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered, the court must consider all pertinent facts, and then listed the Gartenberg factors. The court concluded that the plaintiff's complaint in Yampolsky "rel[ied] heavily on generalities about deficiencies in the securities industry, and statements made by industry critics and insiders," but contained no factual allegations "as to the actual fee negotiations or management and distribution services rendered by these defendants." Id. at *2. Because the complaint did not, "in sum or substance, indicate how or why the fees are 'so disproportionately large that [they] bear [] no reasonable relationship to the services rendered and could not have been the product of arms'-length [sic] bargaining," the court in Yampolsky granted the

defendants' motion to dismiss. Id. (quoting Gartenberg, 694 F.2d at 928.) See also Levy v. Alliance Capital Mgmt., L.P., No. 97 Civ. 4672, 1998 WL 744005, at *4 (S.D.N.Y. Oct. 26, 1998), aff'd, 189 F.3d 461 (2d Cir. 1999) (granting motion to dismiss Section 36(b) claim where plaintiff "fail[ed] to explain how the fees and expenses are excessive in light of the 'Gartenberg' factors").

On appeal, the Second Circuit affirmed the District Court's decision, finding that the allegations included in plaintiffs' complaints failed to include any of the necessary facts pertinent to the relationship between the fees and services which would support their Section 36(b) claim. See Amron v. Morgan Stanley Inv. Advisors Inc., 464 F.3d 338, 344 (2d Cir. 2006). Citing both Gartenberg and Migdal, the Second Circuit compared the various allegations contained in both the Yampolsky and Amron complaints with those six factors relevant to a determination of whether the subject fees were, in fact, excessive, and concluded that "the district court correctly determined Plaintiffs' assertions are inadequate to survive a motion to dismiss." Amron, 464 F.3d at 346.

(10) The court in Wicks v. Putnam Investment Mgmt., LLC, No. Civ. A. 04-10988, 2005 WL 705360 (D. Mass. Mar. 28 2005), did not outright reject or adopt the Gartenberg factors, but instead recognized that "[t]he First Circuit has not expressly adopted the Gartenberg factors or established a specific pleading standard for § 36(b) claims" and agreed with plaintiffs that "Gartenberg–should it be the appropriate standard–does not establish a heightened pleading requirement for § 36(b) excessive fee claims." Id. at *4. The court held that the Rule 8 pleading standard ("a short and plain statement of the claim showing that the pleader[s] [are] entitled to relief") is the appropriate standard and found that the allegations as set forth in the complaint were sufficient to survive a motion to dismiss for failure to state a claim. Id.

(11) In Millenco L.P. v. MEVC Advisors, Inc., No. Civ. 02-142, 2002 WL 31051604 (D. Del. Aug. 21, 2002), plaintiff alleged that the defendant adviser did not invest the cash proceeds of the fund properly, thereby receiving substantial fees for uninvested cash; that defendant did little work for its fees because it did not have the "burden and expense of effecting stockholder redemptions and incur[red] no brokerage transaction costs"; that defendant had little to do

because it subcontracted for management of the fund's cash and investments; that defendant did not compute advisory fees in a timely manner, leading to excessive fees; and the advisory fees were not adjusted despite failure of the fund to obtain approval from the SEC to allow follow-on investments. Id. at *3.

The court declined to apply the Gartenberg factors to plaintiff's Section 36(b) claim at the motion to dismiss stage, stating that Gartenberg "does not set a pleading standard, but rather is helpful only after the complete evidentiary record has been established." Id. at *3 & n.3. The court went on to state that while it was not convinced that plaintiff would ultimately prevail on its claim that the fees charged were "so disproportionately large that they bear no reasonable relationship to the services rendered," plaintiff alleged sufficient facts to defeat the motion to dismiss. Id. at *3-4.

(12) See also Strougo v. BEA Assocs., No. 98 Civ. 3725, 2000 WL 45714, at *6 (S.D.N.Y. Jan. 19, 2000) (holding that the pleading standards under the federal rules "do not contemplate pleadings sufficiently detailed to enable a court to make a determination on a 12(b)(6) motion as to whether the six Gartenberg factors were met" and that "the inquiry at this stage should be whether the Amended Complaint alleges sufficient facts to make out a claim under the more general Gartenberg formulation" of disproportionality under Section 36(b), which it found that the plaintiff had done).

(13) In Reso v. Artisan Partners L.P., No. 11-CV-873, 2011 WL 5826034 (E.D. Wis. Nov. 18, 2011), an investor in several funds managed by Artisan brought suit claiming that Artisan's advisory fees violated Section 36(b) of the Act. The court rejected Artisan's motion to dismiss.

The court first considered Artisan's arguments that many of plaintiff's allegations should be disregarded because they were alleged on "information and belief" and because many were copied from complaints filed by plaintiff's lawyers in other lawsuits. The court rejected these arguments noting that the "mere fact that allegations are somewhat generic and have been pled elsewhere does not give the Court sufficient indicia that [plaintiff's] lawyers failed to reasonably inquire into the circumstances in this case." Id. at *4-5.

The court then evaluated plaintiff's claims using the Gartenberg factors as a framework, and noted that "the Court will deny Artisan's motion to dismiss even if [plaintiff] has failed to allege certain of the Gartenberg factors, so long as [plaintiff's] complaint, taken as a whole, alleges facts that demonstrate a plausible claim for relief under Section 36(b)." Id. at *6.

First, the court found that plaintiff satisfied the factor concerning the independence and conscientiousness of the board by alleging that the directors did not receive sufficient information, and that the directors permitted the funds to pay higher fees than Artisan's institutional clients. While the court noted that "[l]ike many of [plaintiff's] allegations, this one slips in by the skin of its teeth, [the allegations] are sufficient to satisfy the Court at this stage of the case." Id. at *6-7.

The court then found that plaintiff satisfied the nature and quality of services factor by alleging that "other than standard investment advising services, Artisan provides only de minimis services to the funds at issue in this case," and that the funds pay for their own transfer agency, legal and accounting services." Id. at *7. The court also found that despite high Morningstar rankings in other fields, the funds' "F" fee ratings "nonetheless raise an inference that the nature and quality of Artisan's services may be viewed as deficient by outside analysts of mutual funds." Id.

Likewise, the court found that plaintiff satisfied the comparative fees factor by alleging that Artisan charged lower fees and provided higher breakpoints to its institutional clients. Id. at *8-9.

The court found that plaintiff's "strongest" allegations related to the economies of scale factor because plaintiff "sufficiently establish[ed] that Artisan's fee is reduced only slightly over the course of amassing a large amount of assets, but that Artisan does not suffer significant additional expenditures over the course of that expansion. Therefore, the Court finds that Artisan is not appropriately passing on those economies of scale to the mutual funds." Id. at *9.

Finally, the court found that plaintiff satisfied the profitability factor by alleging facts "sufficient to show that Artisan reaps too great a benefit from the funds in this case." Id.

Defendants subsequently filed a motion for summary judgment, but the case settled shortly thereafter. See Reso v. Artisan Partners L.P., No. 11-CV-873, Order (E.D. Wis. Aug. 23, 2012).

(14) In Laborers' Local 265 Pension Fund v. iShares Trust, No. 3:13-cv-00046, 2013 WL 4604183 (M.D. Tenn. Aug. 28, 2013), plaintiffs, investors in certain iShares exchange traded funds, filed a derivative action on behalf of the funds, asserting claims under Sections 36(a), 36(b) and 47(b) of the Act and seeking the return of allegedly "excessive" fees, contractual rescission and injunctive relief. Plaintiffs asserted the claims against the funds as nominal defendants, as well as BlackRock Fund Advisors ("BFA"), BlackRock Institutional Trust Company, N.A. ("BTC") and individual directors of the funds. BFA acted as investment adviser to the funds, while BTC was hired by BFA to act as securities lending agent to the funds. Plaintiffs sought to recover revenue derived from BTC's lending of the funds' securities, alleging that the 35 percent fee-split of this revenue, approved by the funds' directors, was excessive. Id. at *1-2.

Plaintiffs also alleged that an additional 5 percent of securities lending revenue was paid to BlackRock affiliates as administrative fees, resulting in a "40/60 division of revenue between the BlackRock affiliates and the iShares funds" that was likewise excessive, when compared to fees paid by "peer mutual funds, and, in particular, compared to funds which employ unaffiliated lending agents." Id. at *2.

In dismissing plaintiffs' Section 36(b) claim, the court relied primarily on an SEC Exemption Order issued pursuant to Sections 6(c) and 17(b) of the Act, which applied to the securities lending agreement at issue. The court explained that because Section 36(b)(4) of the Act provides that Section 36(b) is inapplicable to payments or compensation made in connection with orders under Section 17 of the Act, plaintiffs' Section 36(b) claim must be dismissed. Id. at *3, *5-6.

The court also dismissed plaintiffs' claims under Sections 36(a) and 47(b), finding that plaintiffs failed to overcome the presumption that no private right of action exists under those sections of the Act. Id. at *6-10.

Although the court's dismissal was without prejudice and provided plaintiffs with an opportunity to file a motion for leave to amend by September 17, 2013, the court specifically noted that if such a motion was not filed, "the court will enter final judgment in the case." Id. at *10. Plaintiffs subsequently sought an extension of time to file their motion by October 17, 2013, which was granted. After the extended deadline passed, on October 22, 2013, defendants moved to dismiss the case, which the court granted shortly thereafter. See Laborers' Local 265 Pension Fund v. iShares Trust, No. 3:13-cv-00046 (M.D. Tenn. Oct. 24, 2013).

Plaintiffs appealed the dismissal of their Section 36(a) and 36(b) claims only. See Laborers' Local 265 Pension Fund v. iShares Trust, 769 F.3d 399 (6th Cir. 2014). On appeal, the United States Court of Appeals for the Sixth Circuit affirmed the district court's decision. Id. at 409.

In affirming the dismissal of plaintiffs' claim under Section 36(b), the Sixth Circuit agreed with the district court that the claim must fail because the SEC Exemption Order triggered the carve-out provision in Section 36(b)(4). Id. at 405.

Moreover, the Sixth Circuit rejected plaintiffs' argument that BTC's lending fee should be aggregated with BFA's separate advisory fee for the purpose of analyzing their claim under Section 36(b) for a number of reasons. Id. at 403-6. First, the court found that the argument was forfeited because the allegations in the complaint pertained only to BTC's lending fee. Id. at 404. Second, even if the complaint had contained specific allegations against BFA's advisory fee, the court noted that the Second Circuit, in Meyer v. Oppenheimer Management Corp., 895 F.2d 861 (2d Cir. 1990), had rejected a similar argument regarding the aggregation of separate fees. Id. at 404. The court adopted the rationale of Meyer and found that BFA's advisory fee was "altogether separate from the lending fee charged by BTC and thus provides no logical basis for aggregating the two." Id. at 404-5. Finally, the court explained that Section 36(b)(3) also undermined plaintiffs' argument because BFA was not a "recipient" of BTC's lending fee as required by the plain text of that provision. Id. at 405.

Turning to plaintiffs' claim under Section 36(a), the Sixth Circuit held that no private cause of action exists under that Section of the Act. Id. at 406-9. In so holding, the court concluded that neither the text nor structure of the Act indicates an intent by Congress to create an implied private right of action under Section 36(a). Id. at 408-9. To support this conclusion, the court explained that "[t]he creation of an express private right of action in Section 36(b) strongly implies the absence of such a right in Section 36(a)." Id. at 408. Furthermore, the court found the language of Section 36(a) lacks language that creates rights, and instead "focuses on the person regulated rather the individuals protected." Id. at 407 (internal quotation and citation omitted).

2. The New Frontier: Manager of Managers Cases

In the so-called "manager of managers" cases, plaintiffs take aim at fund managers that rely on sub-advisers for the provision of investment advisory services, a practice that is particularly prevalent in the insurance industry. Plaintiffs in these actions generally assert that the sub-advisers are performing, with minor exceptions, all of the investment management services, but only receive a "fraction" of the fee paid to the manager. Other "reverse" manager of managers cases have asserted that a manager's fee is excessive because it is substantially higher than the fee the manager charges as a sub-adviser to other fund complexes. These cases are the new frontier of Section 36(b) litigation. Actions are currently pending against AXA Equitable, BlackRock, Davis Advisors, First Eagle, Harbor Capital, The Hartford, ING, J.P Morgan, New York Life, Principal Management, Russell Investments, and SEI Investments.

a. In Curran v. Principal Management Corp., No. 4:09-cv-433, 2010 WL 2889752 (S.D. Iowa June 8, 2010), vacated in part by 2011 WL 223872 (S.D. Iowa Jan. 24, 2011), investors in two "funds of funds" (i.e., mutual funds that invest in other mutual funds), alleged that defendants violated Section 36(b) by charging excessive advisory fees, receiving excessive profits due to economies of scale, and with regard to excessive Rule 12b-1 fees (counts I, II and III, respectively). Notably, plaintiffs brought these claims on behalf of the funds in which they owned shares (i.e., the funds of funds), as well as the underlying funds in which those funds invested. The "funds of funds" and the underlying funds were all part of the Principal fund complex.

Plaintiffs also alleged that the defendant investment adviser relied on sub-advisers to provide investment advisory services to the funds, but still charged the funds a higher fee than what was paid to the sub-advisers. Notably, plaintiffs did not challenge the sub-

advisers' fees, but instead contended those fees proved the excessiveness of the defendant investment adviser's fees. Id. at *8.

At the outset, defendants moved to dismiss plaintiffs' claims on the basis that they lacked statutory standing to assert the claims on behalf of the underlying funds. Id. at *2. While defendants pointed out that plaintiffs failed to allege ownership in the underlying funds, the court noted that plaintiffs were "affected by the fees paid to the investment advisor in the same way as people who directly own shares in the Underlying Funds." Id. at *4 & n.5. Thus, after analyzing the text of Section 36(b), the structure of the ICA, its legislative history, as well as relevant case law, the court concluded that Section 36(b) "creates a private right of action for all 'security holders' in the registered investment company, including persons who possess an interest in a mutual fund that is acquired through a fund of funds . . . ." Id. at *6; but see infra (vacating this portion of the decision).

The court next denied in part and granted in part defendants' motion to dismiss relating to excessive advisory fees. The court concluded that plaintiffs' allegations that the investment adviser "charges more than the subadvisors, who allegedly provide the bulk of investment advice, that the charges do not reflect the benefits derived from economies of scale, and that other institutional clients pay less for the same services, all support a reasonable inference that [the investment adviser] collected excessive fees for its investment advising services of the Subject Funds," and denied defendants' motion to dismiss with regard to the investment adviser that actually received the challenged advisory fees. Curran, 2010 WL 2889752, at *9.

The court granted the motion to dismiss, however, with regard to the funds' distributor, as well as an affiliated investment adviser that was not adequately alleged to have been a recipient of the challenged compensation. Id. at *9-10.

Next, the court dismissed plaintiffs' second claim regarding defendants' alleged receipt of excessive profits from economies of scale. "Because the existence of 'excess profits from economies of scale' does not provide an alternative, independent basis for a § 36(b) claim, Count II will be dismissed." Id. at *10.

Finally, with regard to plaintiffs' Rule 12b-1 claim, the court stated that plaintiffs "have met their burden by alleging that fees collected by [the distributor] for its distribution services surpassed the value of those services, and that the manner in which those fees were assessed did not correspond to the type of services performed but,

rather, resemble fees collected for advisory services." Id. at *11. Noting that defendants' arguments were largely factual in nature, the court concluded that "the allegations set forth in Count III are sufficient to raise an inference that the distribution fees collected by [the distributor] were additional and excessive compensation for advisory services subject to a § 36(b) claim." Id.

Defendants subsequently filed a motion for reconsideration with respect to the issue of statutory standing under Section 36(b) for the underlying funds. The court concluded that its prior interpretation of the relevant statutory language was clearly erroneous, and held that plaintiffs do not have a private right of action pursuant to Section 36(b) to assert claims on behalf of the eighteen underlying funds in which they did not hold any "securities." See Curran v. Principal Mgmt. Corp., LLC, No. 4:09-cv-433, 2011 WL 223872 (S.D. Iowa Jan. 24, 2011).

On May 17, 2013, the parties alerted the court that the surviving portion of the action had settled. The court approved the parties' settlement on June 12, 2013, and dismissed the action with prejudice.

b. In a surprising development, defendants were subsequently sued in another Section 36(b) action involving their funds of funds. In Am. Chems. & Equip., Inc. 401(K) Ret. Plan v. Principal Mgmt. Corp., No. 14-00044, 2014 WL 5426908 (S.D. Iowa Sept. 10, 2014), an investor in six funds of funds brought suit against defendants alleging that they had breached their fiduciary duties under Section 36(b) by charging an excessive acquired fund fee to investors in the funds, and by receiving excessive profits due to economies of scale (counts I and II, respectively). Specifically, with respect to the first count, the plaintiff alleged that the defendants' retention of an acquired fund fee was not justified because the defendants provided no additional services to those performed in exchange for an investment management fee that was also charged to investors. The district court denied defendants' motion to dismiss with respect to count I, but dismissed count II.

First, the court rejected defendants' arguments that the plaintiff lacked statutory standing to bring suit under Section 36(b). Id. at *3. The court found that the plaintiff had been a shareholder in the funds at all relevant times and as such, a "security holder" within the meaning of Section 36(b). Id. at *2. The defendants argued that the plaintiff's claim was identical to the claim in Curran v. Principal Mgmt. Corp., No. 09-00433, 2010 WL 2889752 (S.D. Iowa June 8, 2010), and thus, must be dismissed. Id. at *3. The court, however, found that the plaintiff's claim was distinguishable

because it was specifically limited to only those fees charged to the plaintiff as a shareholder of the Principal Funds. Id. In Curran, by contrast, the plaintiffs brought claims not only on the funds in which they owned shares (i.e., the funds of funds), but also on the underlying funds in which those funds invested. Id.

Next, the court held that the plaintiff alleged sufficient facts to state a claim under Section 36(b). Id. at *7. The court found that the plaintiff had made factual allegations relating to each Gartenberg factor and did not rely solely on speculation. Id. at *4, *7. Specifically, the court noted that the plaintiff had made factual allegations regarding the nature of the defendants' services in relation to the acquired fund fee, and that the plaintiff had alleged that the defendants' fees were high in comparison to other similar funds. Id. at *7. Furthermore, the court found that the plaintiff had sufficiently alleged that the defendants were able to charge an excessive acquired fund fee because the board of directors of the Principal funds was not sufficiently independent and conscientious in reviewing the fee. Id. The court noted that while the plaintiff had "included some generalized statements regarding the mutual fund industry," the complaint also included "specific factual allegations regarding Defendants and their practices." Id.

Finally, the court held that plaintiff's claim for excessive profits due to economies of scale (count II) should be dismissed because excess profits from economies of scale do not provide an independent basis for a claim under Section 36(b). Id. Instead, the court found, that economies of scale is only one of the Gartenberg factors. Id.

The defendants subsequently filed a motion for reconsideration with respect to the issue of statutory standing under Section 36(b). The court rejected all three of defendants' arguments and denied the motion. Am. Chems. & Equip., Inc. 401(K) Ret. Plan v. Principal Mgmt. Corp., No. 14-00044, slip op. (S.D. Iowa Dec. 2, 2014).

First, the court rejected the defendants' argument that the acquired fund fee is not a fee, and is instead only a regulatory disclosure requirement. Slip op. at 3-4. In doing so, the court noted that the plaintiff's complaint repeatedly alleges that the defendants charge investors in the Principal Funds the acquired fund fee and accepted the plaintiff's allegations as true. Slip op. at 4. Next, the court rejected the defendants' argument that the plaintiff cannot challenge the acquired fund fee because the fee is "indirect" and "associated with" the underlying funds, as opposed to the Principal Funds. Slip op. at 4. In doing so, the court explained that

"[n]owhere in the ICA does it indicate that an allegation that the work performed in exchange for an investment adviser's fees is 'indirect' precludes standing." Id. Instead, the court found that "[t]he crucial inquiry" involves whether the plaintiff pays this fee to the defendants. Id. Finally, the defendants reiterated their argument that the plaintiff's claim is indistinguishable from the claim in Curran. Slip op. at 5. The court held that Curran was distinguishable for the same reasons as noted above. Id.

c. In Santomenno v. John Hancock Life Insurance Co., 677 F.3d 178 (3d Cir. 2012), plaintiffs brought suit against defendants for allegedly charging excessive fees on annuity insurance contracts offered to plan participants through which participants could invest in certain mutual funds. Plaintiffs' Section 36(b) claims challenged the structure of those mutual funds, as defendants utilized sub-advisers to provide investment advisory services to the funds. Plaintiffs alleged that defendants' management fees for the funds were excessive because they significantly exceeded the fees paid to the sub-advisers. The district court granted defendants' motion to dismiss on plaintiffs' Section 36(b) claim because plaintiffs "no longer owned any interest in the John Hancock funds." Id. at 181. The Third Circuit affirmed. Id.

The Third Circuit rejected plaintiffs' argument that there is no "continuing ownership requirement" under Section 36(b). The court noted that plaintiffs' "mistakenly assume that the root of the continuous ownership requirement is Rule 23.1. Instead, the prerequisite arises from the fact that Congress directed that only the Securities and Exchange Commission and securities holders, *acting on behalf of the investment company*, could bring an action to enforce the rights created by Section 36(b). As the Court recognized in Daily Income Fund, any recovery in an action brought under Section 36(b) belongs to the investment company. When a plaintiff disposes of his or her holdings in the company, that plaintiff no longer has a stake in the outcome of the litigation because any recovery would inure to the benefit of existing securities holders, not former ones. A continuous ownership requirement gives effect to this 'undeniably derivative' nature of a Section 36(b) claim." Id. at 184 (citations omitted) (emphasis in original).

d. In Sivolella v. AXA Equitable Life Insurance Co., No. 11-4194, 2012 WL 4464040 (D.N.J. Sept. 25, 2012), plaintiff was an investor in a variable annuity administered by defendants, which enabled plaintiff to invest in a variety of mutual funds managed by defendants. Plaintiff brought claims under, inter alia, Section 36(b) alleging that defendants' management fees were excessive

because defendants utilized sub-advisers to provide investment advisory services to the funds, but still charged higher fees than the sub-advisers.

Under the variable annuity, plaintiff made payments to defendants, which were then segregated into a separate account controlled by defendants. The separate account then invested in AXA funds for the benefit of plaintiff. Notably, the AXA funds at issue were sold only to insurance companies and not to the general public. Accordingly, when plaintiff brought claims for a violation of Section 36(b) and unjust enrichment, defendants filed a motion to dismiss on the grounds that plaintiff lacked standing. Id. at *2, 4.

The court noted that defendants' position was that "the term 'security holder,' as used in Section 36(b), refers to the legal or record owner of a security" while plaintiff's position was that "the term refers to the equitable or beneficial owner of a security." Id. at *4.

The court began its analysis by noting that the Act was intended to protect the rights of mutual fund shareholders, and that the term "security holder" was not defined "in order to control situations regardless of the legal form or structure of the investment." Id. (citing Prudential Ins. Co. of Am. v. S.E.C., 326 F.3d 383, 386-88 (3d Cir. 1964)).

The court concluded "it seems to make little sense to broadly construe the word 'security,' and limit the reach of 'holders' to entities that lack any economic interest or stake in the transaction. Here, it would make no sense to limit standing to enforce ICA § 36(b) to AXA or any other entity that did not pay the allegedly excessive compensation [when] Plaintiff and similarly situated investors are responsible for and paid all of the challenged fees. Plaintiff and other investors bear the full risk of poor investment performance. Plaintiff and other investors have the right to instruct AXA how to vote their shares. Assets held in a separate account are immune from claims of AXA's creditors, while being vulnerable to claims of the investors' creditors. And when Plaintiff decides to withdraw her investment in the AXA Funds, she, not AXA, pays the taxes on that investment. Given that, Plaintiff has all of the economic stake in these transactions." Id. at *5 (citation omitted).

The court also rejected defendants' reliance on Curran v. Principal Management Corp., No. 433, 2011 WL 223872 (S.D. Iowa Jan. 24, 2011), which held that an investor in a "fund of funds" is not a "security holder" in the mutual funds invested in by the fund of

funds. The court noted "that in Curran, plaintiffs did not have standing with respect to the underlying funds because they 'd[id] not enjoy any of the incidents of ownership or possession of any security in the Underlying Funds because they d[id] not have the privilege of voting, they d[id] not receive dividends and they d[id] not receive liquidations with regard to the Underlying Funds.' As previously stated, here, Plaintiff has the right to instruct AXA how to vote, dividends enhance the value of her investments, and when she withdraws her investment in the AXA Funds, she will receive those proceeds, as well as any dividends." Sivolella, 2012 WL 4464040, at *5 (quoting Curran, 2011 WL 223872, at *4).[7]

Finally, the court dismissed plaintiff's federal common law unjust enrichment claim because "it is not needed to fill in the interstices of the ICA." Sivolella, 2012 WL 4464040, at *5. Subsequent to the motion to dismiss, the court also struck plaintiff's jury demand. Sivolella v. AXA Equitable Funds Mgmt. LLC, Nos. 11-4194, 13-312, 2013 WL 4096239 (D.N.J. July 3, 2013), adopted by, 2013 WL 4402331 (D.N.J. Aug. 15, 2013). Cross-motions for summary judgment, filed on January 23, 2015, are currently pending in the case.

e. In Kasilag v. Hartford Investment Financial Services, LLC, No. 11-1083, 2012 WL 6568409 (D.N.J. Dec. 17, 2012) investors in six mutual funds alleged that defendant charged excessive investment management fees, as well as excessive Rule 12b-1 fees. With respect to plaintiffs' investment management fee claims, plaintiffs alleged that defendant's management fees were excessive because defendant hired sub-advisers to provide investment advisory services to the funds, but still charged higher management fees than the sub-advisers. Following a motion to dismiss plaintiffs' amended complaint, which was granted in part and

[7] But see SSR II, LLC v. John Hancock Life Ins. Co. (U.S.A.), No. 652793/2011, 2012 WL 4513354 (N.Y. Sup. Ct. Sept. 28, 2012). In this case, an investor in numerous variable life insurance policies chose to invest in a fund ("the underlying fund") that *then* invested in funds that fed into Bernard Madoff's ponzi-scheme. When the investor brought various state claims against the insurance carriers and investment advisers of the underlying fund, the court dismissed several of plaintiff's claims for lack of standing. The court began by noting that it was undisputed that the insurance carriers invested in the underlying fund on behalf of plaintiff "to ensure that the cash value of [plaintiff's] variable life insurance policies could earn investment returns without incurring income taxes." Id. at *2. The court then reasoned that plaintiff could not assert derivative claims on behalf of the underlying fund because plaintiff "is not a partner or investor and has no other type of relation to the [underlying fund] that would permit it to act on behalf of the Fund. In fact, although [plaintiff] seeks to be considered an 'investor,' in the past, it has held itself out *not* to be an 'investor' for [tax] purposes. . . . [Plaintiff] cannot now maintain that it is an investor to avail itself of derivative claims that properly vest in the legal investors (the Carriers)." Id. at *3 (emphasis in original).

denied in part with leave to amend, plaintiffs amended their complaint again. Defendant brought a motion to dismiss both counts of the second amended complaint. Id. at *2.

The court first credited plaintiffs' allegations relating to sub-advisory fees, noting that the complaint alleged that defendant paid sub-advisers to perform substantially all of the services provided to the funds, "at a fraction of the fee [defendant] charges for such services." Id. at *3. The court noted that while this count had been previously dismissed for lack of specificity, the revised complaint added allegations regarding the overlap of services provided by defendant and sub-advisers under the respective agreements, as well as the differences in the fees charged. Id.

The court also rejected defendant's arguments concerning the complaint's comparisons to fees charged by: (1) Vanguard; and (2) by defendant's affiliate to institutional accounts. Id. at *4-5. With respect to the first argument, the court noted that while comparisons to Vanguard are typically of little use in a Section 36(b) case, that such a comparison "is more apt" here because Vanguard and defendant employ the same sub-adviser. The court thus took note that the complaint alleged that investors "in the Funds receive comparable investment management services to the Vanguard funds but pay substantially greater fees." Id. at *5. The court also found defendant's second argument unavailing because plaintiffs alleged that an "apples-to-apples" comparison was possible between retail and institutional clients. This was due to the fact that plaintiffs had also alleged that any services that were only provided to retail funds were provided pursuant to "separate agreements . . . that set them apart from the institutional clients." Id. Significantly, however, the court limited the reach of plaintiffs' institutional fee allegations to the only retail fund that plaintiffs compared to other specific institutional funds. Id.

The court granted without prejudice, however, defendant's motion to dismiss regarding Rule 12b-1 fees. The court based its dismissal on the complaint's "sparse and conclusory" allegations, as well as plaintiffs' failure to establish standing with respect to Class B shares of the funds. Id. at *8-9.

f. In Curd v. SEI Investments Management Corporation, No. 13-07219, slip op. (E.D. Pa. Aug. 28, 2014) investors in five mutual funds alleged, pursuant to Section 36(b), that the defendant charged excessive investment management fees because it hired sub-advisers to provide investment advisory services to the funds, but retained a large portion of the management fees. Defendant filed a motion to dismiss, arguing both that the complaint did not

state a claim under the standard of Jones v. Harris Associates L.P., 130 S. Ct. 1418 (2010), and that the plaintiffs made no timely allegations about SEI's management fees. The district court granted defendant's motion to dismiss the complaint on the latter ground, holding that plaintiffs did not allege that defendant charged excessive fees during the one year period prior to the filing of the complaint on December 11, 2013. Slip op. at n.1. The complaint only contained allegations related to the fees paid to defendant during the funds' 2012 fiscal years, which ended before December 11, 2012. Although Judge Brody's order granted plaintiffs leave to file an amended complaint, she stated that she had "serious doubts about the sufficiency of the allegations in the Complaint as compared to the standard for a violation of Section 36(b)." Id.

Following the decision, plaintiffs filed an amended complaint on October 2, 2014. A motion to dismiss the amended complaint is pending.

g. In Zehrer v. Harbor Capital Advisors, Inc., et al., No. 1:14-cv-00789, 2014 WL 6478054 (N.D. Ill. Nov. 18, 2014), a shareholder of Harbor International Fund filed a Section 36(b) derivative action on behalf of the fund alleging that the fund's advisor, Harbor Capital Advisors, Inc. ("Harbor Capital") charged excessive advisory fees. The plaintiff also named the Harbor International Fund as a nominal defendant. Both Harbor Capital and the fund moved to dismiss the complaint. The district court granted the fund's motion, but denied Harbor Capital's motion. Id. at *1.

According to the plaintiff's allegations, Harbor Capital managed the fund pursuant to an Advisory Agreement. Harbor Capital allegedly delegated its investment management responsibilities to a sub-adviser, Northern Cross, but maintained oversight and supervisory responsibilities for the fund, such as those related to regulatory filings, legal support, and board meetings. Under the Advisory Agreement, Harbor Capital received a fee of 0.75% for the first $12 billion of the Fund's assets under management and 0.65% for assets above $12 billion. For the 2012 fiscal year, the Fund paid Harbor Capital over $225 million. Harbor Capital, in turn, paid Northern Cross approximately $125 million under the Sub-Advisory Agreement. Thus, Harbor Capital retained approximately $100 million in fees. Id.

In denying Harbor Capital's motion to dismiss, the court noted that it was "far from clear" that the plaintiff could meet the high standard for liability under Section 36(b), but found that he alleged sufficient facts to survive a motion to dismiss. Id. at *4. The court

pointed to the plaintiff's allegations that a substantial portion of the tasks assigned to Harbor Capital are performed by Northern Cross, and the responsibilities retained by Harbor Capital are minimal compared to those delegated to Northern Cross. On that issue, Harbor Capital argued that it retains significant responsibilities, but the court found that argument was better suited for summary judgment. Id. at *4.

The court also held that plaintiff's allegations that Harbor Capital received economies of scale benefits as the fund grew but did not pass them on to the fund supported the plaintiff's excessive fee claim. On this issue, the court found that Harbor Capital's argument that it had negotiated additional breakpoints with the Board was also better suited for summary judgment. Id. at *4

With respect to the Harbor International Fund's motion to dismiss, the fund argued that the language of Section 36(b) precludes an action against the fund as a nominal defendant. To that end, Section 36(b) specifically states, "No such action shall be brought or maintained against any person other than the recipient of such compensation or payments…" Id. at *3 (quoting, 15 U.S.C. § 80a-35(b)(3)). In opposition, the plaintiff argued that because a Section 36(b) claim is derivative in nature, he was required to name the fund as a nominal defendant. The court recognized that a corporation is generally a necessary party in derivative actions, but based on the plain language of Section 36(b), held that the fund was not a necessary party in a Section 36(b) action and dismissed the fund from the case. Id. (citing, Millenco, L.P. v. MEVC Advisors, Inc., No. CIV. 02-142, 2002 WL 31051604 at *1, n.2 (D. Del. Aug. 21, 2002)).

Finally, Harbor Capital also moved for relief on two additional issues. First, Harbor Capital moved to strike the plaintiff's demand for a jury trial, which the court granted. Id. at *5. Second, plaintiff requested, as an alternative to damages, rescission of the Advisory Agreement pursuant to Section 47(b) of the Investment Company Act. Id. at *4. Harbor Capital moved to strike this request arguing that rescission is not an appropriate remedy for a Section 36(b) claim, and, even if it were, the plaintiff must first meet the pre-suit demand requirements of Fed. R. Civ. P. 23.1. The court noted that there is a split of authority on whether rescission under Section 47(b) is available to a plaintiff in a Section 36(b) action. The court stated that Section 36(b) is an equitable action that limits money damages to restitution, but does not explicitly foreclose other equitable remedies, such as injunctive relief or rescission. In finding the law unsettled, the court decided not to strike the request for rescission "at this stage" and did not

address the argument that the plaintiff was required to make a pre-suit demand under Rule 23.1. Id.

h. In Goodman v. J.P. Morgan Investment Management, Inc., No. 2:14-cv-414, 2015 WL 965665 (S.D. Ohio Feb. 4, 2015), shareholders of the JPMorgan Core Bond Fund, the JPMorgan High Yield Fund, and the JPMorgan Short Duration Bond Fund brought claims under Section 36(b) alleging that JP Morgan charged excessive management fees. Plaintiffs' principal allegation was that defendant's management fees were excessive because defendant receives lower fees as a sub-adviser to third-party funds than it does as the adviser to the at-issue funds, despite providing the same services to the at-issue funds as it does to the third-party funds.

In the first opinion deciding a motion to dismiss "reverse" manager of managers claims, the court denied JP Morgan's motion to dismiss, holding that the plaintiffs pled "sufficient facts about the fees paid to [JP Morgan] and their relationship to the services rendered to present a plausible claim that the fees are disproportionately large." Id. at *5. Specifically, the court noted that the plaintiffs "pled a notable disparity in the fees obtained for servicing the three funds with which they are involved and the sub-advised funds, while concurrently pleading that the services provided to and resources involved in all of the funds are substantially the same." Id. The court also held that JP Morgan's arguments concerning the differences between the services it provides to the at-issue funds and the third-party funds it sub-advises are more appropriately considered at summary judgment, noting that such arguments "may fully explain why the fees [JP Morgan] earns as an investment adviser justifiably exceed the fees it earns as sub-adviser." Id.

In addition to the foregoing, the court declined to decide whether plaintiffs could properly seek rescission under Section 47(b) as an alternative remedy in connection with their Section 36(b) claims, even though plaintiffs were not pursuing claims under Section 47(b). Id. at *5-6. The court noted that a motion to dismiss "properly targets claims, not remedies." Id. at *6.

i. In In re BlackRock Mutual Funds Advisory Fee Litigation, No. 14-1165, 2015 WL 1418848 (D.N.J. Mar. 27, 2015), plaintiffs asserted Section 36(b) claims on behalf of the BlackRock Global Allocation Fund and the BlackRock Global Equity Dividend Fund (the "Funds") for excessive advisory fees charged by BlackRock Advisors, LLC ("BRA"). Plaintiffs also named BlackRock Investment Management, LLC ("BRIM") and BlackRock

International Limited, the Funds' affiliated sub-advisers, as defendants. The District of New Jersey denied the defendants' motion to dismiss plaintiffs' "reverse" manager of managers allegations, in which they claimed that even though the BlackRock defendants provided the same services to the Funds that they provided as sub-adviser to other unaffiliated funds ("Sub-Advised Funds"), they charged significantly higher advisory fees.

The court first held that plaintiffs' allegations were sufficient to satisfy the comparative fee structures Gartenberg factor and raise a plausible inference that the Funds' fees were excessive. Id. at *5-6. The court noted that plaintiffs supported their allegations by comparing the language in the Funds' investment management agreements with the language in the Sub-Advised Funds' sub-advisory agreements, showing that the contracts required BRA and BRIM to provide the same types of services. Id. at *5. The court also found that plaintiffs alleged that the Funds' and Sub-Advised Funds used the same portfolio managers; used the same research, analysis, technology, and other resources; and had the same investment strategies and held the same types of securities according to language in their respective prospectuses. Id.

The court rejected BlackRock's arguments that it is improper to compare advisory fees and sub-advisory fees, and stated that "the ultimate weight of this comparison" was not before the court on the motion to dismiss. Id. The court also refused to consider defendants' arguments that BRA retained significantly more responsibilities with respect to the Funds than BRIM did with respect to the Sub-Advised Funds, and noted that the arguments were "merit-based" and therefore should not be considered on a motion to dismiss. Id.

Second, the court held that plaintiffs' allegations were sufficient to draw a reasonable inference that BlackRock failed to pass along economies of scale to the Funds, as plaintiffs alleged that: (1) the Funds' breakpoints were too far apart; (2) the Funds' breakpoints did not meaningfully reduce the Funds' advisory fees; and (3) the Funds' growth, and the attendant rise in the fees BRA receives, had not accompanied a proportionate increase in the amount of work performed or costs incurred by BRA. Id. at *6-7.

Finally, the court held that plaintiffs adequately supported their allegations that the Funds' directors failed to act independently or conscientiously when they approved the Funds' investment management agreements. Specifically, the court noted that plaintiffs alleged that: (1) the directors oversaw too many funds to spend the necessary time and attention to assess the advisory fees

paid by the Funds; (2) the directors failed to consider whether the higher fees BRA received from the Funds as compared to other funds reflected differences in the services BRA provided that would justify BRA's higher fees; and (3) truly independent directors would have negotiated a "most favored nation" provision, solicited proposals from other investment advisers, and would not have relied solely on information provided by BlackRock when approving the investment management agreements. Id.

Although the court found that "there are sufficient allegations that allow for an inference of rubber-stamping by the Boards," it recognized that it was "debatable whether the Complaint sets forth allegations of board failure that, alone, would support a plausible claim." Id. at *7. With respect to the allegations as a whole, the court stated that plaintiffs' "evidence is not overwhelming" and the decision to deny the motion to dismiss was not meant to indicate "that [BlackRock's] arguments lack merit, or that the Court finds it likely that Plaintiffs will be able to meet the onerous standard for liability under Section 36(b)." Id. at *8.

3. Former Revenue Sharing Class Actions Repleaded As Excessive Management Fee Claims

a. In In re American Mutual Funds Fee Litigation, No. CV 04-5593, 2005 WL 3989803 (C.D. Cal. Dec. 16, 2005), Judge Feess of the Central District of California granted defendants' motion to dismiss. Similar to other revenue sharing actions, plaintiffs initially purported to assert claims under Section 34(b), 36(a), 36(b), and 48(a) of the Act; Sections 206 and 215 of the Investment Advisers Act of 1940, and state law. Id. at *1. Plaintiffs alleged that defendants paid hundreds of millions of dollars to various brokerage firms to steer investors into mutual funds offered by the funds' investment adviser. Judge Feess dismissed the Section 36(b) claim, with leave to replead, for failure to plead that cause of action derivatively, rather than directly. Id. at *3. The court found the "source of confusion on the nature of Section 36(b) is one sentence in Kamen v. Kemper Fin. Servs., Inc., 500 U.S. 90, 108-09 (1991)," wherein the Supreme Court called a Section 36(b) claim "direct." In re American, 2005 WL 3989803, at *3. But, the court held, the Supreme Court's characterization was not meant to undo previous holdings or the text of the statute and, in fact, "the [Supreme Court] added *in the very next sentence* that 'it can hardly be maintained that a shareholder's exercise of his state-created prerogative to initiate *a derivative suit without the consent of the directors* frustrates the broader policy objectives of the [Act].'" Id. (emphasis in original). The court thus dismissed the Section 36(b) claim, adding that,

should plaintiffs decide to replead, they "must allege specific facts regarding the disproportionately high nature of the fees in questions." Id. at *4 (suggesting plaintiffs be guided by the discussions in Gartenberg and Migdal).

The court made two additional holdings with respect to Section 36(b). First, the court held that the Section 36(b) claim would be dismissed *with* prejudice as to conduct before July 19, 2003, "because of the explicit one-year statute of limitations in Section 36(b)." In re American, 2005 WL 3989803, at *4. Second, the court dismissed the claim *with* prejudice as to the director defendants because Section 36(b) only applies to recipients of the fees in question and the "[director defendants'] benefit, if any, from the scheme was indirect." Id.

Following the court's ruling on defendants' motion to dismiss, plaintiffs filed a second amended complaint, asserting several causes of action, including purported violations of Sections 36(b) and 48(a) of the ICA, and federal and state antitrust laws. In re American Mutual Funds Fee Litig., No. CV 04-5593, slip op. (C.D. Cal. Jan. 17, 2007). Defendants moved to dismiss the second amended complaint in its entirety. With respect to the amended excessive fee claim under Section 36(b), defendants argued that the previous complaint was insufficient to constitute an "action" for purposes of Section 36(b)'s one year look-back damages period because it was improperly asserted directly as a putative class action rather than derivatively on behalf of the subject funds. According to defendants, the "action" was instituted once plaintiffs asserted their Section 36(b) claim derivatively and that plaintiffs had failed to allege any facts within the applicable one-year period. Moreover, Defendants also argued, consistent with Judge Martini's decision in In re Lord Abbett Mutual Funds Fee Litig., 463 F. Supp. 2d 505 (D.N.J. 2006), that the court's previous decision dismissing state law as preempted under SLUSA required the dismissal of the entire action, including plaintiffs' Section 36(b) claim.

Judge Feess disagreed with defendants' interpretation of the word "action" as it relates to Section 36(b)'s one-year look back period, finding that "so long as a plaintiff has filed suit under [Section 36(b)], even if it is defective and must be revised or amended, a Section 36(b) action has been instituted." In re American, slip op. at 4. Moreover, the court rejected defendants' argument that the court's prior dismissal of plaintiffs' state law claims as preempted under SLUSA required the dismissal of the entire action, finding that "Congress did not intend to preclude a plaintiff from pursuing legitimate, federal securities claims merely by including them in a

lawsuit that also contained covered, pre-empted claims." Id. at 6. Accordingly, the court denied defendants' motion to dismiss plaintiffs' Section 36(b) claim. Plaintiffs had dismissed the antitrust claims before defendants' motion to dismiss was fully submitted.

Following more than two years of extensive fact and expert discovery, the parties declined to file motions for summary judgment and proceeded directly to trial. The case was tried from July 28, 2009 through August 7, 2009, before Judge Feess in the Central District of California, marking the first time in more than 20 years that a Section 36(b) case has been fully tried on the merits. The plaintiffs' excessive fee claim was directed at eight of the 30 funds in the American Fund complex. Sixteen witness testified at trial: 11 fact witnesses and five experts. One of the principle theories advanced by plaintiffs at trial was that the eight funds had experienced significant growth in assets under management during the period 2003-2008, and that such growth negatively impacted the investment results of those funds. Plaintiffs claimed, among other things, that, as a result of this negative impact, Rule 12b-1 fees, which contributed to the growth of the funds, were excessive. Plaintiffs also attacked investment advisory, transfer agent, and administrative service fees as excessive. After receiving post-trial briefing, Judge Feess entertained "closing" arguments on September 2, 2009.

Thereafter, the court announced its "intended decision," finding that plaintiffs failed to meet their burden of establishing that the fees in question were so disproportionate to the services rendered that they could not have been the result of arm's-length bargaining. With respect to plaintiffs' claim regarding 12b-1 fees, the court indicated that plaintiffs' theory spoke only to the use of such fees, and that plaintiffs failed to adduce evidence establishing that the nature and quality of the services provided in exchange for those fees was disproportionate. In addition, the court found that plaintiffs failed to establish that the growth in assets under management had any negative impact on investment results. Judge Fees also refused to apply the standards articulated by the Seventh Circuit in Jones and the Eight Circuit in Gallus, finding that both were inconsistent with Section 36(b) itself. Judge Feess found that the proper standard was that articulated in Gartenberg and its progeny. At the directive of Judge Fees, the Defendants submitted post-trial proposed findings of fact and conclusions of law on October 2, 2009.

On December 28, 2009, Judge Feess issued a 105-page opinion, containing extensive Findings of Fact and Conclusions of Law that

echoed, in large part, the holdings included in his prior "intended decision." In doing so, Judge Feess rejected each of the plaintiffs' principal theories of liability and ruled for defendants on all of the major substantive issues presented, including the standard for liability under Section 36(b) and each of the Gartenberg factors. See In re Am. Mutual Funds Fee Litig., No. CV 04-5593, 2009 WL 5215755 (C.D. Cal. Dec. 28, 2009).

As an initial matter, the court found that "the proper legal standard to be applied to Plaintiffs' excessive fee claims under Section 36(b) is the standard set forth in Gartenberg," and squarely rejected the alternative standards set forth in both Jones v. Harris, 527 F.3d 627 (7th Cir. 2008), and Gallus v. Ameriprise, 561 F.3d 816 (8th Cir. 2009). See In re Am. Mutual Funds Fee Litig., 2009 WL 5215755, at *43. However, the Court found that "Section 36(b) does not require Plaintiffs' to establish that the fees charged by Defendants were excessive in the aggregate. Plaintiffs may challenge a particular fee and may prevail on their Section 36(b) claim if they can show that such a fee was disproportionate to the services rendered in exchange for that fee." See In re Am. Mutual Funds Fee Litig., 2009 WL 5215755, at *44.

Next, the court addressed the nature and quality of services provided to the funds and their corresponding shareholders, noting that the "long-term performance of the majority of the funds at issue ranged from good to excellent in five-year, ten-year, and lifetime intervals," and the "Funds' very high shareholder retention rates and low level of complaints are consistent with shareholder satisfaction with the level of services provided." Id. at *18, 48. As a result, the court found that the plaintiffs failed to offer any evidence undermining the conclusion that defendants' investment advisory services were anything other than of the highest quality. See id. at *49.

With respect to profitability, the court found that defendants overall "profit levels" ranged from pre-tax operating margins of 30% to 35%, which "fall within the range of profit margins that other courts have deemed acceptable under Section 36(b)" Id. at *50. As to economies of scale, the court began its analysis by noting that the existence of scale is "properly analyzed at the fund complex level and not at the fund level." Id. at *28. After finding that economies of scale can be shared with fund shareholders in a number of ways, including breakpoints, fee reductions, fee waivers, offering low fees from inception, or making additional investments to enhance shareholder services, the court held that plaintiffs had "failed to sustain their burden of proving the existence of economies of scale" and "any economies of scale that

may have been realized during the relevant period were sufficiently shared with investors." Id. at *51, 52 (internal citations omitted).

According to the court, the independent directors of the American Funds were "successful, well-educated business people with knowledge regarding financial markets and financial services," were "well-qualified with significant experience relevant to the performance of their duties," and were given "extensive" and "comprehensive" materials which "provided sufficient factual detail and explanatory background to allow [them] to fulfill their responsibilities to Fund Shareholders." Id. at *31, 53, 54. Although the independent directors "did not diligently inquire into some issues of importance and failed to recognize the consequence of some of the information presented to them," the court nevertheless held that overall the conduct of the directors met the Gartenberg standard. Thus, the court concluded, based on the entirety of the record before it, that the independent directors diligently exercised their responsibility in approving the fees at issue. See In re Am. Mutual Funds Fee Litig., 2009 WL 5215755, at *55-56.

As indicated in its "intended decision," the court found that plaintiffs failed to establish the growth in assets under management had any negative impact on investment results. Indeed, to the contrary, the court held that the growth of the American Funds during the 2003 through 2008 time-period actually "benefited the Funds in a number of ways." Id. at *14. For example, "the fees paid by the Funds declined (in percentage terms) as a result of growth via breakpoints, waivers, and reductions in the other fees charged to the Funds." Id. Moreover, the court concluded that "the size of the Funds has [also] led to lower brokerage commissions, enhanced [Capital Research]'s competitive advantage in trading, and led to better service from trading partners," (id.) and "[t]here was no persuasive evidence demonstrating that the size and growth of the funds negatively impacted the Funds' performance" Id. at *16. Indeed, the court found that "[s]ome of the Funds best investment results came during the period when the Funds were at their largest, and some of the largest and fastest growing funds were among the best performing." Id.

Finally, the court concluded that defendants' fees were lower than industry averages for comparable funds, and that plaintiffs adduced no evidence that defendants had realized any so-called fallout benefits. See id. at *53. As a result, plaintiffs "failed to sustain their burden of proving that [Capital Research] charged fees that

were 'so disproportionally large that [they bore] no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining'" and entered judgment for defendants. Id.

When plaintiffs appealed Judge Feess's decision, the Ninth Circuit affirmed the ruling "in large part for the reasons stated in the district court's comprehensive order." Jelinek v. Capital Research & Mgmt. Co., 448 F. App'x 716 (9th Cir. 2011).

b. In In re Salomon Smith Barney Mutual Fund Fees Litigation, 441 F. Supp. 2d 579 (S.D.N.Y. 2006), another revenue sharing action, plaintiffs alleged that Salomon Smith Barney ("SSB") and certain affiliated entities engaged in a scheme consisting of three components: (1) SSB offered undisclosed incentives to brokers and financial advisers to steer investors into SSB's proprietary funds and other funds with which SSB had undisclosed "kickback" arrangements; (2) SSB extracted improper fees from investors in its proprietary funds; and (3) SSB caused its proprietary funds to invest in poorly performing companies because of their status as SSB investment banking clients. See id. at 583-85. Plaintiffs asserted claims under Sections 11, 12(a)(2), and 15 of the Securities Act of 1933; Sections 10(b) and 20(a) and Rules 10b-5 and 10b-10 of the Securities Exchange Act of 1934; Sections 34(b), 36(b), and 48(a) of the Act; and various claims under state law. Defendants moved to dismiss the complaint in its entirety including plaintiffs' Section 36(b) claim, arguing, inter alia, that the claim was improperly asserted directly as a putative class action rather than derivatively on behalf of the subject funds and that plaintiffs' Section 36(b) allegations were insufficient to state a claim.

Judge Crotty agreed, and dismissed plaintiffs' Section 36(b) cause of action. The court first addressed defendants' argument that a Section 36(b) claim may only be properly asserted derivatively on behalf of the funds rather than directly by fund shareholders. Distinguishing the Supreme Court's decisions in Fox and Kamen as dealing with the applicability of the demand requirement of Rule 23.1 of the Federal Rules of Civil Procedure, the court held that Section 36(b) confers a derivative, and not a direct, right of action and dismissed plaintiffs' claim accordingly. See id. at 593-97. Moreover, the court also found that the allegations in the complaint were insufficient to state a claim under Section 36(b). First, plaintiffs' allegations regarding improper Rule 12b-1 fees, soft dollars, and commissions fell outside the scope of Section 36(b), which covers only the receipt of compensation by investment advisers and their affiliates, not compensation paid to

brokers and other third parties. Id. at 600-01. Second, absent any allegation that the total fees charged were disproportionate to the services provided, plaintiffs' allegations regarding the improper use of fees charged to the funds were insufficient to state a claim under Section 36(b). Id. at 601-03 (citing In re Eaton Vance Mutual Funds Fee Litig., 403 F. Supp. 2d 310 (S.D.N.Y. 2005)). The court granted plaintiffs leave to replead the Section 36(b) claims as a derivative claim and advised plaintiffs to be mindful of the pleading standards of Section 36(b) and Gartenberg in doing so. See Salomon Smith Barney, 441 F. Supp. 2d at 603.

In response to Judge Crotty's July 26, 2006 decision, plaintiffs filed a Second Consolidated Amended Complaint on behalf of nine individual SSB mutual funds, alleging violations of Section 36(b) of the Act. Defendants again moved to dismiss, arguing that plaintiffs' allegations in support of their Section 36(b) claim failed to state a cause of action. The court agreed. Citing the Second Circuit's opinion in Amron v. Morgan Stanley Investment Advisors, Inc., 464 F.3d 338 (2d Cir. 2006), Judge Crotty noted that, in order to survive dismissal at the initial pleading stage, a plaintiff must set forth those facts necessary to a finding that the fees were excessive, on a factor-by-factor basis. See Salomon Smith Barney, 528 F. Supp. 2d 332, 337 (S.D.N.Y. 2007). Prior to conducting its own analysis of the allegations set forth by plaintiffs, the court noted that Judge Sweet, in a substantially similar case, applied the analysis employed by the Second Circuit in Amron and found the allegations insufficient to withstand dismissal. See id. at 337 n.7. The court next conducted a factor-by-factor analysis of the allegations contained in the Second Consolidated Amended Complaint and, relying on the Second Circuit's decision in Amron, held that plaintiffs "failed to allege sufficient facts to support any of the Gartenberg factors." Id. at 339. Moreover, the court noted that during the course of oral argument on defendants' motion to dismiss, "[p]laintiffs' counsel conceded that he could not identify any case in the Second Circuit or Southern District of New York where allegations [of improper revenue sharing resulting in excessive fees] have satisfied" the standard adopted by Gartenberg and reaffirmed by Amron. The court dismissed the complaint in its entirety, with prejudice. Id. Plaintiffs appealed the court's dismissal to the Second Circuit, which heard oral argument in the matter in March 2009.

The Second Circuit noted that dismissal was warranted with regard to most of plaintiffs' Section 36(b) claims, but reversed the district court with regard to plaintiffs' transfer agent fees claim. Plaintiffs alleged that SSB caused the funds to replace its transfer agent with an SSB affiliate. "Once it replaced the existing agent, the SSB

affiliate then sub-contracted with that agent to continue to perform virtually the same services that it had previously performed, but at a steep discount. Rather than pass the resulting savings on to investors in the form of lower fees, SSB's affiliate kept the windfall, permitting Defendants to profit at the expense of the SSB Funds and their investors." R.W. Grand Lodge of F. & A. M. of Pa. v. Salomon Bros. All Cap Value Fund, 425 F. App'x 25, 30 (2d Cir. 2011).

The court noted that plaintiffs' claim "constitutes a garden variety breach of fiduciary duty. We recently considered similar allegations in a case argued in tandem with this one, and involving some of the same defendants [and] determined that, as a result of the alleged transfer agent arrangement, the 'shareholders were being grossly overcharged for transfer agent services and [the investment adviser] was reaping the benefits.' In effect, 'the Fund investors . . . were at the mercy of a faithless fiduciary.' We have little trouble concluding that, as alleged, transfer agent services fees resulting from this particular arrangement bear no reasonable relationship to the services rendered, could not have been the product of arm's length bargaining, and as a result, adequately support an alleged violation of section 36(b)." Id. at 30-31 (quoting Operating Local 649 Annuity Trust Fund. Smith Barney Fund Mgmt. LLC, 595 F.3d 86, 93 (2d Cir. 2010)).

C. Attempts to Expand the Scope of Section 36(b)

In the last decade, the "themes" pursued by plaintiffs changed. In addition to alleging that an adviser's fees are "excessive," plaintiffs now invoke Section 36(b) to challenge fund distribution and trading practices, failure to participate in class action settlements in connection with portfolio securities, and the adviser's portfolio selections for the fund. Plaintiffs also are attacking the structure of the fees themselves as *per se* violations of Section 36(b), without necessarily alleging that they are excessive or disproportionate to the services rendered.

There were approximately 25 of the "revenue sharing" cases pending in federal courts around the nation. Those cases, along with the Settlement Participation Class Actions, are attempts by the plaintiffs' bar to expand the scope of Section 36(b). In contrast to the "pure" excessive management fee actions, courts have issued many more decisions in the revenue sharing line of cases—all since August 1, 2005. There have also been numerous decisions involving the Settlement Participation Class Actions.

More recently, the Supreme Court's decision in Jones, et al. v. Harris Associates, L.P. potentially closes the door on plaintiffs' attempts to expand Section 36(b) beyond pure excessive fee claims.

1. Distribution Practices—Directed Brokerage, Revenue Sharing, and Rule 12b-1 Plans

Directed Brokerage & Revenue Sharing

a. The court in In re Eaton Vance Mutual Funds Fee Litigation, 380 F. Supp. 2d 222 (S.D.N.Y. 2005), adhered to on reconsideration by 403 F. Supp. 2d 310 (S.D.N.Y. 2005), was the first court to decide a motion to dismiss in one of the revenue sharing actions. In Eaton Vance, Plaintiffs alleged that the investment advisers, distributor, and trustees of the Eaton Vance Funds breached their fiduciary duties under Section 36(b) by improperly charging investors in the Funds purported Rule 12b-1 marketing fees, and by drawing on the assets of the Funds to make undisclosed payments of soft dollars and excessive commissions, in violation of Rule 12b-1. Id. at 227, 236. Defendants argued that: (1) plaintiffs' claim concerned payments outside the scope of Section 36(b); (2) the claim did not adequately allege excessive fees; and (3) the fees alleged were received by brokers and not by the investment advisers, the distributor, or the trustees. Id. at 236. In a thoughtful and persuasive opinion, Judge John G. Koeltl dismissed plaintiffs' claim under Section 36(b) of the Act because plaintiffs failed to allege that defendants charged excessive fees. See id. at 237-38.

The court rejected defendants' first argument, relying on the Second Circuit's decision in Meyer v. Oppenheimer Mgmt. Corp. to hold that Section 36(b) applies to 12b-1 fees. Id. at 236-37. However, the court agreed with defendants' second argument. "In order to state a claim under § 36(b), the plaintiffs must allege that the defendant violated its fiduciary duty under § 36(b) by receiving fees that were 'so disproportionately large' that they bore 'no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining.'" Id. at 237 (quoting Meyer, 895 F.2d at 866). Judge Koeltl set out the six factors identified in Gartenberg and concluded that plaintiffs failed to properly allege a claim under Section 36(b). "The allegations that the defendants authorized improper 12b-1 fees, soft dollar payments, and commissions to brokers are insufficient to allege a claim under 36(b), which addresses only the negotiation and enforcement of payment arrangements between investment advisers and funds, not whether investment advisers acted improperly in the use of the funds." Id. at 237. The court also agreed with defendants' third argument and dismissed the claim as against the investment advisers and the trustees for the additional reason that claims under Section 36(b) may only be brought against the recipient of the allegedly excessive fees. Id. at 238; see also In re Davis Selected Mutual Funds Litig., No. 04 Civ. 4186,

2005 WL 2509732, at *2 (S.D.N.Y. Oct. 11, 2005) (adopting Judge Koeltl's reasoning in the Eaton Vance decision and holding in a case containing "substantially the same allegations" that the plaintiffs failed to state a claim under Section 36(b) because the complaint did not allege that the funds were charged excessive fees by defendants).

Plaintiffs moved for reconsideration, arguing that they sufficiently alleged excessive fees under the notice pleading standard of Fed. R. Civ. P. 8 and that the operative complaint alleged excessive, rather than improper, fees. The court found no grounds to reconsider its decision dismissing the Section 36(b) claim and confirmed that aspect of its decision. See In re Eaton Vance Mutual Funds Fee Litig., 403 F. Supp. 2d 310 (S.D.N.Y. 2005). The court held that "while the plaintiffs need not necessarily allege any specific factor identified in [Gartenberg] to meet the notice pleading standard for an excessive fee claim, the plaintiffs must still allege facts demonstrating how the fee 'is so disproportionately large that is bears no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining,'" and had not done so. Id. at 314. The court rejected plaintiffs' argument that the fees were excessive because plaintiffs received no benefit from fees that were put to allegedly improper use. Id. at 315. Judge Koeltl also held that the complaint contained no allegations concerning a failure to pass on any benefits of economies of scale. "Even though [the Section 36(b) claim] repeats and realleges every previous allegation in the [complaint], nowhere in the [complaint] do the plaintiffs ever allege that the failure to pass on benefits from economies of scale was a violation of § 36(b)." Id. at 315. The court also confirmed its prior decision dismissing the Section 36(b) claim against the investment advisers and the trustees because they did not receive the challenged payments. Id. at 316.

In holding that the Section 36(b) would be dismissed with prejudice, the court addressed defendants' previous argument that a claim for excessive fees must be plead derivatively, rather than directly as plaintiffs had done:

> While the Court did not rule on this argument, the Court notes that there is strong support for it. See Olmsted, 283 F.3d at 433 (noting § 36(b) is a "private right of derivative action"); In re Franklin Mutual Funds Fee Litig., 388 F. Supp. 2d at 468 (dismissing claim because "§ 36(b) does not provide for a direct private right of action"); In re Lord Abbett Mutual Funds Fee Litig., 385 F. Supp. 2d 471, 489 (D.N.J. 2005) (the plaintiffs "may not maintain [a § 36(b)

> claim] as a class action claim, given the derivative nature of the claim"); Mutchka v. Harris, 373 F. Supp. 2d 1021, 1025 (C.D. Cal. 2005) (section 36(b) claim "must fail because it has not been brought derivatively").

In re Eaton Vance, 403 F. Supp. 2d at 320.

On appeal, the Second Circuit affirmed the District Court's decision. See Bellikoff v. Eaton Vance Corp., 481 F.3d 110 (2d Cir. 2007). With respect to plaintiffs' allegations relating to the Investment Adviser Defendants and the Trustee Defendants, the Court held that they were not alleged to have been recipients of the commissions and fees at issue, and therefore were not subject to liability under Section 36(b), holding this to be "fatal" to the plaintiffs' claims. The Court also held that plaintiffs' allegations that the fees at issue were merely "improper" were insufficient to satisfy the pleading requirements of Section 36(b), as set forth in Gartenberg, so as to sustain liability against the Distributor Defendants. See id. at 117-18.

b. In In re Lord Abbett Mutual Funds Fee Litigation, 385 F. Supp. 2d 471 (D.N.J.), amended and superseded by 407 F. Supp. 2d 616 (D.N.J. 2005), plaintiffs asserted class and derivative claims alleging that brokers were compensated excessively as an incentive for them to steer new investors into Lord Abbett mutual funds. Plaintiffs alleged broker compensation was excessive because it included, above the standard compensation for executing portfolio transactions and selling shares, either revenue sharing payments or soft dollar payments. The adviser also allegedly treated brokers to lavish vacations and directed brokerage business to brokers who steered clients into Lord Abbett Funds. See In re Lord Abbett, 385 F. Supp. 2d at 475-76. Plaintiff purported to bring, inter alia, a direct claim for breach of fiduciary duty under Section 36(b).

The court sua sponte concluded that a Section 36(b) claim can be maintained only as a derivative, rather than a direct claim, and accordingly dismissed plaintiffs' direct Section 36(b) class action claim. In re Lord Abbett, 385 F. Supp. 2d at 488. In so holding, Judge Martini cited the Supreme Court's decision in Daily Income Fund, Inc. v. Fox, 464 U.S. 523, 535 n.11 (1984), which stated "unequivocally" that Section 36(b) confers only a derivative right of action. The court noted that the Supreme Court's decision in Kamen v. Kemper Fin. Servs., Inc., 500 U.S. 90, 108 (1991), does not alter this conclusion, finding that when examined in context, Kamen merely states that a shareholder may bring a derivative claim under Section 36(b) without making a pre-complaint demand; that suit, however, remains a derivative action brought on

behalf of the company. In re Lord Abbett, 385 F. Supp. 2d at 488 n.6. The court dismissed the Section 36(b) claim without prejudice.

Plaintiffs moved for reconsideration, arguing that the court's holding is contrary to Supreme Court precedent, and ignored Section 36(b)'s supposed distinction between claims by shareholders and claims by the fund. Explaining that he previously considered and rejected precisely these arguments in his decision on defendants' motion to dismiss, Judge Martini denied plaintiffs' motion. In re Lord Abbett Mutual Funds Fee Litig., 417 F. Supp. 2d 624 (D.N.J. 2005).

Although Judge Martini had previously provided plaintiffs with leave to amend the complaint to assert a Section 36(b) claim derivatively, the Lord Abbett Defendants moved for reconsideration, arguing that the court's previous decision dismissing state law claims as preempted under SLUSA required dismissal with prejudice of the action in toto. See In re Lord Abbett Mutual Funds Fee Litig., 463 F. Supp. 2d 505, 509 (D.N.J. 2006). Judge Martini agreed, finding that the plain language of SLUSA required dismissal of the entire "covered class action" rather than mere "counts," "claims," or "allegations." The court noted that such an interpretation was consistent with the Supreme Court's recent decision in Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit, 126 S. Ct. 1503 (2006), which recognized that Congress intended SLUSA's preemptive powers to be broadly construed. See In re Lord Abbett, 463 F. Supp. 2d at 513-14. Because the use of the phrase "covered class action" required dismissal of the entire class action, including plaintiffs' Section 36(b) claim, the court held that the previous dismissal of the Section 36(b) claim had to be with prejudice. Id. at 515.

Plaintiffs appealed Judge Martini's decision. In a case of first impression, the Third Circuit reversed and remanded for further proceedings. See In re Lord Abbett Mutual Funds Fee Litigation, 553 F.3d 248 (3d Cir. 2009). The court held that the word "action" in the language of SLUSA is modified by the phrase "based upon the statutory or common law of any State." Id. at 255. As such, and in light of the legislative history of SLUSA, the court held that SLUSA does not mandate dismissal of an action in its entirety where the action includes only some "pre-empted" claims. Id. at 255-56.

c. In In re Franklin Mutual Funds Fee Litigation, 388 F. Supp. 2d 451 (D.N.J. 2005), Judge Martini observed that in Daily Income Fund, Inc. v. Fox, 464 U.S. 523, 535 n.11 (1984), the Supreme Court

"unequivocally" stated that Section 36(b) confers only a derivative right of action. In re Franklin, 388 F. Supp. 2d at 468.[8] The court held that to the extent Fox distinguished a derivative claim under Section 36(b) from a typical derivative claim, the Supreme Court did so only to explain why Federal Rule of Civil Procedure 23.1 is inapplicable to Section 36(b) actions. Id. The court recognized as correct plaintiffs' argument that shareholders—not mutual funds—have the right to sue under Section 36(b), but found that this fact does not give plaintiffs a direct right of action. Id. Similar to his decision in In re Lord Abbett, Judge Martini noted that the Supreme Court's decision in Kamen v. Kemper Financial Services, Inc., 500 U.S. 90, 108 (1991) does not alter this conclusion. In re Franklin, 388 F. Supp. 2d at 468 n.12.

Plaintiffs moved for reconsideration of the court's holding that claims under Section 36(b) are derivative, making the same arguments as plaintiffs in In re Lord Abbett. Judge Martini denied reconsideration for the same reasons as he did in Lord Abbett. See In re Franklin Mutual Funds Fee Litig., No. 04-CV-982, slip op. (D.N.J. Dec. 28, 2005).

As in In re Lord Abbett, Judge Martini had previously provided plaintiffs with leave to amend the complaint to assert a Section 36(b) claim derivatively and plaintiffs had done so. See In re Franklin Mutual Funds Excessive Fee Litig., 478 F. Supp. 2d 677, 680 (D.N.J. 2007). Defendants thereafter moved to dismiss, arguing that the previous complaint was insufficient to constitute an "action" for purposes of Section 36(b)'s one year look-back damages period because it was improperly asserted directly as a putative class action rather than derivatively on behalf of the subject funds. According to defendants, the "action" was instituted once plaintiffs asserted their Section 36(b) claim derivatively and that plaintiffs had failed to allege sufficient facts within the applicable one-year period. The court agreed. Citing the plain language of Section 36(b)(3) and Judge Cercone's recent decision in Brever v. Federated Equity Mgmt. Co., 233 F.R.D. 429, 433 (W.D. Pa. 2005), the court found that a plaintiff may only seek damages for conduct occurring during the one year look-back period, and that the applicable damages period does not continue forward. See Franklin Mutual Funds, 478 F. Supp. 2d at 684-86. Judge Martini agreed with defendants' interpretation of the word

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8 Here, however, Defendants had argued that plaintiffs' direct Section 36(b) claim should be dismissed because a Section 36(b) claim can be maintained only derivatively, rather than as a direct claim. Id. at 467. The court did not raise the issue sua sponte as it had in Lord Abbett.

"action" as it relates to Section 36(b)'s one-year look back period, finding that "it is apparent that the one-year period for recovering damages under [Section] 36(b) begins when a plaintiff institutes a derivative action under that section." Id. at 684. In addition, the court held that plaintiffs could not avail themselves of the "relation back" of amendments provision of Fed. R. Civ. P. 15(c). See Franklin Mutual Funds, 478 F. Supp. 2d at 685. According to the court, Section 36(b)(3)'s one year look-back period is a substantive provision that cannot be abridged, enlarged, or modified by a procedural rule, as is consistent with the Rules Enabling Act, 28 U.S.C. § 2072. Accordingly, because plaintiffs did not assert their claim derivatively until March 10, 2006, the substantive one year look back period for claims brought pursuant to Section 36(b) was for the one year period preceding the filing of their derivative action. With that in mind, the court reviewed the relevant allegations in the complaint that related to the applicable one year period, concluding that such allegations were inadequate to state a claim, and dismissed plaintiffs' complaint. See Franklin Mutual Funds, 478 F. Supp. 2d at 686-88.

d. In In re Dreyfus Mutual Funds Fee Litigation, 428 F. Supp. 2d 342 (W.D. Pa. 2005), another revenue sharing action, plaintiffs were shareholders in two of the mutual funds managed by Dreyfus and Founders Asset Management. Plaintiffs alleged a variety of class action and derivative claims against the parent companies, investment advisers, distributors, and directors of the Dreyfus Funds. Plaintiffs' principal allegations were that the defendants made undisclosed, improper, and excessive payments to broker-dealers to promote the sale of the Dreyfus Funds over other mutual funds and that these undisclosed payments created an inherent conflict of interest. Plaintiffs asserted claims under Section 34(b), 36(a), 36(b), and 48(a) of the Act; Sections 206 and 215 of the Investment Advisers Act of 1940; and common law claims for breach of fiduciary duty, aiding and abetting a breach of fiduciary duty, and unjust enrichment. Defendants moved to dismiss the complaint in its entirety, arguing that: (1) there is no implied private right of action under Sections 34(b) and 36(a) of the Act; (2) plaintiffs failed to state a claim under Sections 36(b) and 48(a) of the Act; (3) that plaintiffs' claims under Sections 34(b) and 36(a) of the Act (as well as plaintiffs' state law claims) should have been brought derivatively rather than directly; and (4) plaintiffs lacked standing to sue on behalf of funds in which they do not own shares.

With respect to Section 36(b), the court held that "the definitive question [under Section 36(b)] is whether the investors got their money's worth out of their investment managers, not whether the

fee structures were right or wrong, fair or unfair, or high or low." Id. at 350. Thus, allegations centering on the "wrongfulness" of the compensation paid, without regard to the services rendered, "do not support a Section 36(b) claim." Id. But, the court held, allegations that the fees were excessive because savings realized from economies of scale were not passed on to the investors, and that the directors were neither independent nor conscientious, while a "close call," are sufficient to survive a motion to dismiss. Thus, the court allowed the claim under Section 36(b) against the investment advisers and the distributor to proceed. Id. at 350.[9]

Following the court's ruling on defendants' motion to dismiss, Dreyfus moved for judgment on the pleadings pursuant to Fed. R. Civ. P. Rule 12(c), asserting that plaintiffs' Section 36(b) claim was improperly brought directly as a putative class action rather than derivatively on behalf of the subject funds. See In re Dreyfus Mutual Funds Fee Litig., 428 F. Supp. 2d 357 (W.D. Pa. 2006). The court agreed, noting that both Supreme Court precedent as well as the plain language of Section 36(b) require that any claim brought pursuant to Section 36(b) to be done so derivatively on behalf of the funds. See id. at 359-60. In so holding, the court analyzed the Supreme Court's decisions in Burks v. Lasker, 441 U.S. 471 (1979), Daily Income Fund, Inc. v. Fox, 464 U.S. 523 (1984), and Kamen v. Kemper Financial Services, Inc., 500 U.S. 90 (1991), and found that while Section 36(b) claims are not derivative for purposes of Fed. R. Civ. P. Rule 23.1, which requires pre-suit demand on the fund's board of directors, such claims are derivative, "in the general sense of the word, because they are asserted on behalf of all shareholders and result in no direct benefit to the individual plaintiff shareholders." Dreyfus, 428 F. Supp. 2d at 359. In addition, the court noted that "recent authority" examining the issue has held, in accordance with Supreme Court precedent, that Section 36(b) claims must be brought derivatively. See id. at 359-60 (citing Olmsted v. Pruco Life Ins. Co. of New Jersey, 283 F.3d 429, 433 (2d Cir. 2002); In re American Mutual Funds Fee Litig., No. CV 04-5593, 2005 WL

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[9] The court dismissed the Section 36(b) claim with respect to the directors and the nominal defendants because the directors and the funds were not recipients of compensation, as required by the statute. Id. at 350-52. The court also dismissed the former distributor of the funds on statute of limitations grounds. Id. at 352. The court permitted plaintiffs' claim under Section 48(a) of the Act to proceed to the extent it was based on the surviving claim under Section 36(b). Id. at 356.

The court declined to address defendants' standing argument, stating that "[b]ecause a section 36(b) claim is not brought derivatively, we need not address the funds on whose behalf this claim can be brought." Id. at 350 n.7.

3989803, at *3 (C.D. Cal. Dec. 16, 2005); In re Franklin Mutual Funds Fee Litig., 388 F. Supp. 2d 451, 468 (D.N.J. 2005); In re Lord Abbett Mutual Funds Fee Litig., 407 F. Supp. 2d 616, 633 (D.N.J. 2005); Mutchka v. Harris, 373 F. Supp. 2d 1021, 1025 (C.D. Cal. 2005); In re Eaton Vance Mutual Funds Fee Litig., 403 F. Supp. 2d 310, 320 (S.D.N.Y. 2005)). Finally, the court reviewed the plain language of Section 36(b), noting that the text of Section 36(b) specifically mandates that any private action be brought "on behalf of" the investment company and is "not brought independently to recover damages to compensate for a personal wrong to an individual shareholder." Dreyfus, 428 F. Supp. 2d at 360. Thus, the court dismissed both plaintiffs' remaining Section 36(b) claim as well as their cause of action under Section 48(a) for failure to allege a primary violation under the Act. Id.

e. In In re AllianceBernstein Mutual Fund Excessive Fee Litigation, No. 04 Civ. 4885, 2005 WL 2677753 (S.D.N.Y. Oct. 19, 2005), recons. granted and opinion vacated in part by No. 04 Civ. 4885, 2006 WL 74439 (S.D.N.Y. Jan. 11, 2006), plaintiffs similarly alleged that the advisers, distributors, directors, and other affiliates of the AllianceBernstein family of mutual funds violated Sections 34(b), 36(a), 36(b), and 48(a) of the Act; Section 206 and 215 of the Investment Advisers Act of 1940; and common law by making allegedly improper and undisclosed revenue sharing payments to brokers. On defendants' motion to dismiss the action, the court held that plaintiffs adequately stated a claim under Section 36(b) because they alleged that: (1) economies of scale from the funds' growth were not shared with fund shareholders through lower fees or increased services; (2) defendants made payments to brokers that were not in accordance with a valid Rule 12b-1 plan; (3) defendants diverted soft dollars to brokers at the expense of fund shareholders; and (4) certain of the directors were not independent. See 2005 WL 2677753, at *4-6. Judge Kram allowed the Section 36(b) claim to proceed only against the advisers, dismissing the claim as to the distributors, directors, and other defendants because they were not recipients of the allegedly excessive advisory fees. See id. at *6-7. Moreover, the court limited the Section 36(b) claim to the thirteen funds that plaintiffs personally owned, holding that plaintiffs lacked standing to sue on behalf of investors in the other forty-eight AllianceBernstein funds in which they did not own shares. See id. at *9-10.

The investment adviser defendants moved for reconsideration of the court's opinion with respect to Section 36(b), arguing that the court had overlooked the fact that plaintiffs' economies of scale allegations (made for only one of the thirteen funds at issue) did

not pertain to the one-year time period at issue, and that the funds' net assets and expense ratio actually decreased during the relevant time period The court agreed that the statistics defendants presented "dilute the lone facts supporting Plaintiffs' claim that the Funds' investment advisers failed to pass on savings generated by economies of scale to shareholders." In re AllianceBernstein Mutual Fund Excessive Fee Litig., No. 04 Civ. 4885, 2006 WL 74439, at *2 (S.D.N.Y. Jan. 11, 2006).

Defendants also argued that plaintiffs' allegations that the directors were not independent did not take into account the Act's statutory presumption of director independence as well as cases such as Verkouteren v. BlackRock Fin. Mgmt., Inc., No. 98 Civ. 4673, 1999 WL 511411 (S.D.N.Y. July 20, 1999), aff'd, 208 F.3d 204 (2d Cir. 2000); Krantz v. Prudential Invs. Fund Mgmt. LLC, 305 F.3d 140, 143-44 (3d Cir. 2002), cert. denied, 537 U.S. 1113 (2003); and Migdal v. Rowe Price-Fleming Int'l, Inc., 248 F.3d 321, 331 (4th Cir. 2001), which dismissed Section 36(b) claims for failure to rebut that presumption. The court agreed that AllianceBernstein had identified relevant case law previously overlooked by the court which supported the conclusion that plaintiffs' allegations failed to rebut the Act's statutory presumption of director independence. In re AllianceBernstein, 2006 WL 74439, at *3. The court thus concluded that the relevant case law, legislative history, and public filings identified in "comprehensive briefing" served to "undermine this Court's previous calculation of the legal force of the facts pled in the Complaint." Id. The court vacated its previous ruling upholding plaintiffs' Section 36(b) claim and dismissed the remaining claim.

In response to Judge Kram's January 11, 2006 dismissal of plaintiffs' Section 36(b) claim, plaintiffs moved for leave to file yet another amended complaint in an effort to cure the purported deficiencies in their previous complaint. See In re AllianceBernstein Mutual Fund Excessive Fee Litig., No. 04 Civ. 4885, 2006 WL 1520222 (S.D.N.Y. May 31, 2006). After briefly reviewing the newly pleaded allegations in the proposed amended complaint, the court found that the allegations remained materially deficient and that further attempts to replead their Section 36(b) claim would be futile. Id. at *1-2. As such, the court denied plaintiffs' motion to amend their complaint and instructed the clerk of the court to re-enter judgment and dismiss the case with prejudice. Id. at *3.

f. In In re Columbia Entities Litigation, No. 04-11704, 2005 U.S. Dist. LEXIS 33439 (D. Mass. Nov. 30, 2005), plaintiffs brought claims under Sections 34(b), 36(a), 36(b), and 48(a) of the Act and

under Sections 206 and 215 of the Investment Advisers Act of 1940, as well as state law claims for breach of fiduciary duty and unjust enrichment. Plaintiffs alleged that defendants used Columbia Funds assets to pay kickbacks to brokerages in exchange for the brokerages' pushing clients to Columbia Funds. Plaintiffs also alleged that defendants paid brokerages to push the Columbia Funds through the use of directed brokerage. Plaintiffs asserted that they were harmed by these practices because defendants charged them excessive fees in order to fund the alleged payments to brokerages and because the investment advisers faced conflicts of interest that prevented them from acting in plaintiffs' best interests. See id. at *9-12. Defendants moved to dismiss. With respect to the claim under Section 36(b), defendants argued that: (1) the claim should have been brought derivatively, rather than directly; (2) plaintiffs lacked standing to bring the claim on behalf of funds in which they had no ownership interest; and (3) the claim nevertheless failed to state a cause of action.

The court rejected defendants' argument that the Section 36(b) claim should have been brought derivatively. Judge Keeton held that Section 36(b) explicitly provides for a private right of action and Supreme Court precedent confirmed that Section 36(b) provides for a direct, not a derivative, action. Id. at *18-19 (citing Daily Income Fund, Inc. v. Fox, 464 U.S. 523, 540-41 (1984)).[10]

With respect to the merits of the Section 36(b) claim, after reviewing the Second Circuit's decision in Gartenberg and other relevant law, the court held that plaintiffs failed to allege that defendants received compensation of any sort, as required by Section 36(b). In re Columbia, 2005 U.S. Dist. LEXIS 33439, at *32. "Instead, they allege that defendants *paid* kick-backs and other incentives out of the Columbia Funds assets. Although this allegation, if true, may have acted to the detriment of the assets of the funds, such payments, even if undisclosed, are not a breach of the fiduciary duty protected by Section 36(b)." Id. (emphasis in

[10] The court also dismissed plaintiffs' claim under Section 36(a) of the Act, finding it redundant:

> From the wording of [Sections 36(a) and (b)], it appears that investors need only bring an action pursuant to either Section 36(a) or Section 36(b). If investors bring their action pursuant to Section 36(a), which provides a right of action for the Securities and Exchange Commission, the court can read Section 36(b) to infer a private right of action. If investors have also brought an action pursuant to Section 36(b), however, the 36(a) action is merely redundant.

Id. at *26-27.

original). Thus, the court dismissed the Section 36(b) claim in its entirety.

g. In <u>In re Goldman Sachs Mutual Funds Fee Litigation</u>, No. 04 Civ. 2567, 2006 WL 126772 (S.D.N.Y. Jan. 17, 2006), plaintiffs brought claims under Section 34(b), 36(a), 36(b), and 48(a) of the Act and Sections 206 and 216 of the Investment Advisers Act of 1940, as well as state law claims for breach of fiduciary duty and unjust enrichment. Plaintiffs alleged that defendants charged the Goldman Sachs Funds' shareholders excessive fees, which were then used to pay kickbacks to brokerage firms to steer new investors into the Funds. Plaintiffs further alleged that the existing shareholders received no benefit from the economies of scale that theoretically should have resulted from the increased assets in the funds. <u>Id.</u> at *1-4.

Judge Buchwald dismissed the Section 36(b) claim in its entirety. At the outset, Judge Buchwald held that plaintiffs failed to allege that the "Trustee/Officer Defendants" actually received investment advisory or Rule 12b-1 fees. The court rejected plaintiffs' argument that the Trustee/Officer Defendants violated Section 36(b) by receiving their compensation despite the fact that they violated their fiduciary duties. Judge Buchwald found that this allegation did not meet the requirements of Section 36(b) because this compensation does not constitute receipt of payments for advisory services or Rule 12b-1 fees. <u>Id.</u> at *7-8.

With respect to the other defendants, the court held that plaintiffs failed to allege facts demonstrating the lack of any reasonable relationship between fees received and services provided by the distributor and adviser defendants. Judge Buchwald concluded that plaintiffs failed to allege that either the advisory fees or Rule 12b-1 fees were disproportionate to the services rendered, as required by Section 36(b). The court noted that plaintiffs' allegations regarding Rule 12b-1 fees could not establish that the <u>advisory</u> fees were excessive, and that mere assertions that fees increased with the size of the funds could not establish that benefits from economies of scale were not passed on to investors. In addition, merely asserting that Rule 12b-1 fees were charged while the funds at issue were closed to new investors did not adequately allege that the fees charged were disproportionate to the services rendered. Finally, the court held that the kickback allegations did not constitute support for the excessive Rule 12b-1 allegations. <u>Id.</u> 8-10. Judge Buchwald dismissed the Section 36(b) claim in its entirety.

h. In Forsythe v. Sun Life Financial, Inc., 417 F. Supp. 2d 100 (D. Mass. 2006), plaintiffs alleged that defendants made substantial payments to brokers in exchange for the brokers' steering unwitting clients to invest in funds in the Massachusetts Financial Services ("MFS") family of funds. Defendants moved to dismiss the complaint in its entirety.

Judge O'Toole held that plaintiffs stated a claim under Section 36(b). After reviewing the Gartenberg factors and noting that the First Circuit has not expressly adopted these factors, Judge O'Toole opined that Gartenberg does not establish a heightened pleading standard for Section 36(b) claims and that plaintiffs' failure to plead facts that specifically address the Gartenberg factors was not in itself a ground for dismissal. See Forsythe, 417 F. Supp. 2d at 114.

Judge O'Toole found that defendants were correct that plaintiffs must allege some connection between the wrongs alleged and excessive compensation of an investment adviser or affiliated persons. However, the court was unwilling to conclude at the motion to dismiss stage that a Section 36(b) claim may not attack the lawfulness of excessive Rule 12b-1 fees, soft dollar payments, and excessive broker commissions despite the fact that such payments may not be "advisory fees" in the most literal sense. The court concluded that plaintiffs satisfied the notice pleading requirements of Fed. R. Civ. P. 8 by alleging in some factual detail wrongful conduct specific to defendants**.** See id. at 115-16.

Judge O'Toole also rejected defendants' argument that the claim should be dismissed because plaintiffs failed to allege sufficient facts that, if proven, would demonstrate that the services rendered by defendants were disproportionate to the fees charged. While plaintiffs did not make any allegations regarding the quality of services rendered, the court found that such allegations may be irrelevant to their theory of excessiveness. Plaintiffs' theory was that the fees were excessive because they were unauthorized and taken from fund assets solely for the defendants' benefit; in other words, fees amounting to "something for nothing" are inherently excessive. Judge O'Toole noted that at least one court in a different Section 36(b) context concluded that the wrongful retention of monies by an adviser that were in essence "something for nothing" could represent a disproportionate relationship between fees and services. See Forsythe, 417 F. Supp. 2d at 116 (citing Jones v. Harris Assocs. L.P., Civ. No. 04 C 8305, 2005 WL 831301, at *3 (N.D. Ill. Apr. 7, 2005)).

The court did, however, find that plaintiffs' Section 36(b) claim improperly claimed damages for a greater period than is allowed by the statute, and appeared to claim damages against the trustee defendants, who were not proper defendants under the statute. The surviving Section 36(b) claim was limited accordingly. See Forsythe, 417 F. Supp. 2d at 116-17.

Judge O'Toole also held that plaintiffs lacked standing to assert any Section 36(b) claim except on behalf of the two funds in which they owned shares at the time the lawsuit was filed, and dismissed the claim against the rest of the funds. Judge O'Toole stated that this conclusion followed not only from the plain statutory language, but also from the unique nature of the Section 36(b) cause of action. The court rejected plaintiffs' argument that they had standing to sue because the MFS Funds allegedly engaged in a common course of wrongful conduct. Judge O'Toole stated that each fund should be treated as a separate and distinct entity in the Section 36(b) context and a plaintiff may not use the corporate structure of the broader investment company to confer standing. The court concluded that plaintiffs may not use a class action to bootstrap themselves into standing that they lack. See Forsythe, 417 F. Supp. 2d at 117-18.

Following Judge O'Toole's decision denying defendants' motion to dismiss plaintiffs' Section 36(b) claim, defendants' filed a motion for a protective order in an effort to secure a decision declaring that the damages period applicable to Section 36(b) claims was limited to only the one year period before the filing of the complaint. See Forsythe v. Sun Life Fin., Inc., 475 F. Supp. 2d 122 (D. Mass. 2007). Plaintiffs opposed defendants' motion, arguing that the period for which damages may be awarded under Section 36(b) begins one year before the filing of the complaint and continues until the complaint is fully adjudicated and that, even if the court were to limit damages to those accruing within the one year period prior to the commencement of the lawsuit, discovery should not necessarily be limited to events occurring within that limited period. See id. at 123-24. In support of their position, defendants' cited numerous cases, including the Supreme Court's decision in Daily Income Fund v. Fox, 464 U.S. 523, 526 n.2 (1984). After briefly addressing each of the cases cited by defendants in turn, the court noted that, with the sole exception of a lone order by a magistrate judge, "[i]n all of these cases, the courts were considering the effect of § 36(b)(3)'s backward-looking limitation, and not whether that section imposed a forward-looking one." Forsythe, 475 F. Supp. 2d at 127. With respect to Daily Income, the court found that "the Court's brief reference to the damages period was casual dictum, not a controlling holding," and

concluded that Section 36(b)(3) permits ongoing damages on a forward-looking basis. Id. at 128. Accordingly, the court denied defendants' motion for a protective order.

i. In In re Oppenheimer Funds Fees Litigation, 419 F. Supp. 2d 593 (S.D.N.Y. 2006), another revenue sharing action, plaintiffs were shareholders in 23 Oppenheimer-branded mutual funds managed by OppenheimerFunds, Inc. and its affiliate, OppenheimerFunds Services. Plaintiffs alleged a variety of class and derivative claims against the parent corporation, investment advisers, distributors, and a select group of trustees, directors and officers of the Oppenheimer Funds. The crux of plaintiffs' complaint was a fraudulent scheme whereby the defendants made "improper secret payments" from fund assets to unaffiliated broker-dealers in an effort to induce those broker-dealers to push Oppenheimer Funds "more aggressively" to consumers, the result of which benefited the defendants at the expense of the Oppenheimer Funds. Plaintiffs also alleged that investment advisers improperly inflated their own fees in an effort to finance these payments and failed to pass onto Oppenheimer Fund shareholders the benefits of scale economies resulting from the increases in Fund assets. Plaintiffs asserted claims under Sections 34(b), 36(a), 36(b) and 48(a) of the Act; Sections 206 and 208 of the Investment Advisers Act of 1940; and state common law claims for breach of fiduciary duty and unjust enrichment. Defendants moved to dismiss the complaint in its entirety arguing, inter alia, that: (1) there is no private right of action under Sections 34(b), 36(a), and 48(a) of the Act; (2) plaintiffs' state common law claims were improperly brought directly as a putative class action and should have been asserted derivatively on behalf of the subject funds; (3) plaintiffs failed to make pre-suit demand or, alternatively, failed to plead futility with the requisite particularly for those claims brought derivatively pursuant to the Investment Advisers Act of 1940; and (4) plaintiffs failed to state a claim under Section 36(b) of the Act.

Although the court granted defendants' motion to dismiss with respect to the overwhelming majority of claims, it did sustain plaintiffs' Section 36(b) cause of action, finding that plaintiffs' allegations that defendants inflated their fees "so as to provide a slush fund for making some of the illicit payments" to unaffiliated broker-dealers "barely" survived the minimal pleading requirements of Fed. R. Civ. P. 8(a), despite the fact that the allegations were "poorly pled." Id. at 596-97 (citing Paragraph 220 of Amended Complaint). The court did, however, dismiss the Section 36(b) claim with respect to all defendants except the investment advisers, noting that only the investment advisers were

recipients of advisory compensation, as required by the Act. See id. at 597.

The investment adviser defendants moved for reconsideration of the court's opinion with respect to Section 36(b), arguing that the court's conclusion that paragraph 220 of the amended complaint supported a claim overlooked the fact that the theory as to why the subject fees were "excessive" was not one permitted by law. Specifically, defendants argued that the only allegation in the amended complaint pertaining to the "excessiveness" of the fees at issue involved plaintiffs' contention that increases in advisory fees were used to create a "slush fund to bribe brokers for the benefit of the investment advisers and their affiliates," and were not for the benefit of Oppenheimer Fund shareholders. Defendants claimed that plaintiffs were, in essence, advocating for a determination that such fees were *per se* "excessive," in violation of Section 36(b). The court agreed, noting that plaintiffs had failed to make any specific factual allegation, as required by Gartenberg v. Merrill Lynch Asset Management, Inc., 694 F.2d 923 (2d Cir. 1982), as to why the added amounts rendered the advisory fees disproportionate to the services rendered. See In re Oppenheimer Funds Fee Litig., 426 F. Supp. 2d 157, 158-59 (S.D.N.Y. 2006). The court vacated its previous ruling sustaining plaintiffs' Section 36(b) claim against the investment adviser defendants and dismissed, with prejudice, the remaining claim. See id. at 159.

j. In In re BlackRock Mutual Funds Fee Litigation, No. 04 Civ. 164, 2006 WL 4683167 (W.D. Pa. Mar. 29, 2006), plaintiffs similarly alleged that defendant BlackRock, Inc., and certain of its subsidiaries and affiliates, made improper "shelf-space" payments to unaffiliated broker-dealers in exchange for "aggressively" marketing BlackRock-branded mutual funds to "unwitting investors." According to plaintiffs, these improper payments were in several different forms, and included: (1) directed brokerage; (2) revenue sharing; and (3) so-called "soft-dollar" payments. Plaintiffs alleged that these payments violated: (1) Sections 34(b), 36(a), 36(b) and 48(a) of the ICA; (2) Section 215 of the Investment Advisers Act of 1940; and (3) state common law, including breach of fiduciary duty, aiding and abetting breach of fiduciary duty, unjust enrichment, and claims for anticompetitive conduct.

Defendants moved to dismiss the complaint in its entirety, including plaintiffs' Section 36(b) claim. According to defendants, the Section 36(b) claim was improperly brought directly as a putative class action, rather than derivatively on behalf of the subject funds. The court agreed with defendants, and dismissed

plaintiffs' Section 36(b) claim. See id. at *9-10. Citing the plain language of the statute and the Supreme Court's decisions in Daily Income Fund, Inc. v. Fox, 464 U.S. 523 (1984) and Kamen v. Kemper Financial Services, Inc., 500 U.S. 90 (1991), the court held that Section 36(b) confers a derivative, and not a direct, right of action even though such an action is not subject to the demand requirement of Rule 23.1. See BlackRock, 2006 WL 4683167, at *9-10.

k. In In re Evergreen Mutual Funds Fee Litigation, 423 F. Supp. 2d 249 (S.D.N.Y. 2006), plaintiffs alleged that defendants engaged in a purported "kickback scheme" whereby they made undisclosed and improper payments to unaffiliated broker-dealers in an effort to induce these brokers to steer unwitting investors into Evergreen-branded mutual funds. Plaintiffs further alleged that the addition of new investors resulted in a marked increase in fund assets, the benefits of which were improperly retained by the investment adviser and its affiliates, and not passed on to fund shareholders. Based upon these allegations, plaintiffs brought the following claims against the investment adviser, distributor, trustees, officers, and other affiliates of the Evergreen family of mutual funds: (1) Sections 34(b), 36(a), 36(b) and 48(a) of the Act; (2) Section 215 of the Investment Advisers Act of 1940; and (3) a myriad of state common law claims, including breach of fiduciary duty, aiding and abetting breach of fiduciary duty, unjust enrichment, and claims for anticompetitive conduct. Defendants moved to dismiss plaintiffs' complaint in its entirely, including plaintiffs' Section 36(b) claim, arguing that: (1) the conduct at issue was not actionable under Section 36(b); and (2) plaintiffs failed to plead facts evidencing that the fees at issue were "excessive." See id. at 257.

Judge Sweet agreed and dismissed plaintiffs' Section 36(b) claim in its entirety. Citing the Second Circuit's decision in Gartenberg, the court concluded that a plaintiff asserting a claim under Section 36(b) must allege some facts demonstrating that the fees at issue are so disproportionately large that they bear no reasonable relationship to the services rendered. Noting that the allegations contained in the complaint were substantially similar to those at issue in both In re Eaton Vance Mutual Funds Fee Litigation and In re Goldman Sachs Mutual Funds Fee Litigation, Judge Sweet held that plaintiffs' allegations of revenue sharing were insufficient to sustain a claim under Section 36(b) because the complained of conduct related to the improper use of the subject fees, not that the fees themselves were excessive. See Evergreen, 423 F. Supp. 2d at 257-59. Moreover, the court dismissed the Section 36(b) claim with respect to the distributor defendant and trustees/officers for

the additional reason that the complaint failed to allege that those defendants were recipients of compensation, as required by Section 36(b)(3). See id. at 259.

In response to Judge Sweet's March 27, 2006 dismissal of plaintiffs' Section 36(b) claim, plaintiffs moved to set aside the court's previous order or, alternatively, for leave to file a second amended complaint in an effort to cure the deficiencies in their previous complaint. See In re Evergreen Mutual Funds Fee Litig., 240 F.R.D. 115 (S.D.N.Y. 2007). After briefly reviewing the standards applicable to a motion for reconsideration, the court found that it had not overlooked plaintiffs' prior allegations relating to economies of scale and the purported increase in management fees allegedly used to subsidize the adviser's improper payments to unaffiliated broker-dealers. The court, therefore, denied plaintiffs motion for reconsideration, noting that plaintiffs had failed to demonstrate, as a threshold requirement, the existence of allegations that were not previously considered by the court. See id. at 117-20.

The court then rejected plaintiffs' motion for leave to file yet another amended complaint, finding that further attempts to replead their Section 36(b) claim would be futile. See id. at 119-22. Citing Gartenberg v. Merrill Lynch Asset Management, Inc., 694 F.2d 923 (2d Cir. 1982), the court analyzed each of the six relevant factors in turn, and concluded that plaintiffs' proposed second amended complaint continued to suffer from material pleading deficiencies, and affirmed its earlier ruling dismissing the complaint in its entirety.

l. In In re Morgan Stanley & Van Kampen Mutual Fund Securities Litigation, No. 03 Civ. 8208, 2006 WL 1008138 (S.D.N.Y. Apr. 18, 2006), plaintiffs brought a myriad of claims relating to Morgan Stanley's revenue sharing program. According to plaintiffs, Morgan Stanley provided incentives to its sales force of individual registered representatives to promote the sales of its proprietary funds. Plaintiffs claimed that these sales incentives and Morgan Stanley's failure to disclose them constituted violations of Sections 11, 12 and 15 of the Securities Act of 1933; Sections 10(b) and 20(a) and Rule 10b-5 of the Securities Exchange Act of 1934; Sections 34(b), 36(b), and 48(a) of the Act; Sections 206 and 215 of the Investment Advisers Act of 1940, as well as state law claims for breach of fiduciary duty. With respect to plaintiffs' Section 36(b) claim, plaintiffs alleged that defendants purported use of improper Rule 12b-1 distribution fees, soft dollars, and the payment of "excessive commissions" by the investment advisers rendered defendants advisory fees "excessive" in violation of

Section 36(b). The court disagreed, noting that the Second Circuit's decision in Gartenberg provided six factors courts should consider when determining whether the advisory fees at issue are "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" and found that plaintiff's allegations pertaining to expense ratios and use of soft-dollars were "too vague and conclusory to meet the requirements of Gartenberg." Id. at *12. Citing Judge Koeltl's decision in Eaton Vance, the court found that plaintiffs' allegations fell outside the applicable scope of Section 36(b), "which addresses only the negotiation and enforcement of payment arrangements between investment advisers and funds, not whether investment advisers acted improperly in the use of the funds" and dismissed plaintiffs' Section 36(b) claim in its entirety. Id. at *13.

m. In In re Merrill Lynch Investment Management Funds Securities Litigation, 434 F. Supp. 2d 233 (S.D.N.Y. 2006), plaintiffs alleged that Merrill Lynch and related defendants entered into agreements with certain mutual funds pursuant to which Merrill Lynch received payments from the funds in exchange for providing financial and other incentives to its sales force to sell the funds. Plaintiffs claimed that these distribution arrangements and Merrill Lynch's failure to disclose them constituted violations of Sections 12 and 15 of the Securities Act of 1933; Sections 10(b) and 20(a) and Rule 10b-5 of the Securities Exchange Act of 1934; Sections 34(b), 36(a), 36(b), and 48(a) of the Investment Company Act of 1940; Sections 206 and 215 of the Investment Advisers Act of 1940; and state law. With respect to the claim brought pursuant to Section 36(b), plaintiffs alleged that the investment adviser and distributor defendants charged "inflated" and "excessive" distribution and advisory fees. Defendants moved to dismiss the complaint in its entirely. Citing Gartenberg, the court agreed and dismissed plaintiffs' Section 36(b) claim, holding that plaintiffs' allegations were "conclusory" and devoid of any "factual support" and determined that plaintiffs failure to allege any facts about the negotiations of the fees at issue or the services provided in exchange for those fees required dismissal even under the liberal pleading standards of Rule 8. Id. at 240-41.

n. In Siemers v. Wells Fargo & Co., No. C 05-4518, 2006 WL 2355411 (N.D. Cal. Aug. 14, 2006), plaintiff asserted numerous claims relating to Wells Fargo's revenue sharing program. According to plaintiff, Wells Fargo and certain related defendants engaged in a purportedly undisclosed "scheme" to pay unaffiliated third party broker-dealers in an effort to induce their customers into purchasing Wells Fargo-branded mutual funds. Plaintiff

alleged that he was harmed by: (1) receiving biased advice from broker-dealers; and (2) the dissipation of fund assets by paying purportedly "excessive" fees to the investment advisers and distributor defendants. Plaintiff claimed that these "kickback" arrangements and Wells Fargo's failure to disclose them constituted violations of Sections 12 and 15 of the Securities Act of 1933; Sections 10(b) and 20(a) and Rule 10b-5 of the Securities Exchange Act of 1934; and Sections 36(b) and 48(a) of the Act. With respect to plaintiff's Section 36(b) claim, plaintiff alleged that: (1) as the funds' assets grew as a result of this purported "scheme," the benefits of such growth were improperly retained by defendants and were not shared with fund shareholders; (2) the expense ratios for the funds were higher than those for similarly situated funds in other complexes; (3) the funds' performance was poor and, therefore, the fees were not justified; (4) the investment adviser defendants improperly caused the funds to pay "higher-than-usual commissions" to financial consultants for services already being performed by the adviser and sub-adviser; (5) the funds' directors either failed to receive or declined to consider relevant information necessary for determining that any benefits resulting from increased fund assets were shared with the funds; and (6) defendants' "shelf-space" program conferred no benefit to the funds and its investors because defendants increased their fees in order to recoup the costs of direct payments to the broker-dealers. Id. at *16.

Defendants moved to dismiss plaintiff's Section 36(b) claim in its entirety, arguing that the plain language of Section 36(b) bars only the receipt of "excessive" fees but not the purportedly inappropriate use of fees. Moreover, defendants asserted that the plaintiff's allegations were too general in nature and not of the type mandated under Gartenberg and its progeny. The court disagreed. First, the court noted that neither the Supreme Court nor the Ninth Circuit have set forth standards for pleading a claim brought pursuant to Section 36(b), and that Gartenberg has limited precedential value outside of the Second Circuit. Moreover, the court noted that even if the standard enunciated by the Second Circuit was applicable, Gartenberg "did not purport to determine how to state a claim (i.e., set pleading standards), much less assert a heightened pleading standard." Id. at *18 (internal quotations omitted). After noting that the relevant factors courts should consider when determining the sufficiency of a claim brought pursuant to Section 36(b) are not limited to those detailed in Gartenberg, the court reviewed each factor in turn and determined that plaintiff's claim was, in fact, adequately plead. Despite this, the court found that the plaintiff failed to allege that he owned any of the relevant funds on the date the suit was commenced and

dismissed plaintiff's claim under Section 36(b) with leave to replead. Id. at *21.

In an attempt to cure the deficiencies identified in the court's August 14, 2006 ruling, the plaintiff filed an amended complaint based upon the same complained-of conduct relating to defendants' improper and undisclosed revenue sharing agreements with unaffiliated broker-dealers. See Siemers v. Wells Fargo & Co., No. C 05-4518, 2006 WL 3041090 (N.D. Cal. Oct. 24, 2006). Defendants again moved to dismiss plaintiff's Section 36(b) claim, arguing that the plaintiff lacked standing to sue on behalf of eighty-seven Wells Fargo-branded funds which he did not own, and the plaintiff's allegations concerning one of the distributor defendants, Stephens Inc., were insufficient to state a claim. According to defendants, the second amended complaint failed to allege that Stephens was: (1) an affiliate of any of the Wells Fargo-related defendants; (2) an "investment adviser" to the funds; or (3) an officer, director, advisory board member, or underwriter of any of the subject funds. After noting that the defendants were correct insofar as the complaint itself does not contain anything other than a reference to Stephens as a "distributor," the court noted that the funds' prospectuses specifically referred to Stephens as a "principal underwriter." According to the court, because the relevant prospectuses were incorporated into the complaint by reference, the plaintiff had, in fact, alleged and demonstrated that Stephens was a proper defendant under Section 36(b). See id. at *7-8.

Following several additional rounds of motion practice pertaining to various other alleged deficiencies in the operative complaint, the plaintiff filed a motion for class certification with respect to those claims alleging violations of Sections 10(b) and 20(a) and Rule 10b-5 of the Securities Exchange Act of 1934. See Siemers v. Wells Fargo & Co., 243 F.R.D. 369 (N.D. Cal. 2007). After an extensive analysis of the applicable standard for class certification pursuant to Rule 23, the court appointed lead plaintiff Siemers as the class representative and certified a class of "[a]ll purchasers of shares (of any class) bought between November 4, 2000, and June 8, 2005" for four mutual funds within the Wells Fargo family of funds. Id. at 371. With respect to plaintiff's claim asserting a violation of Section 36(b), the court bifurcated the proceeding and stayed plaintiff's Section 36(b) claim. Id. at 375. Importantly, the court found that, with respect to the remaining claims under the Exchange Act, the plaintiff would be required to demonstrate—to a jury—that the Adviser Defendant had a practice of extracting excessive advisory and other fees from the four funds, and that the excessiveness of such fees would be judged under the factors set

forth in Gartenberg v. Merrill Lynch Asset Management, Inc., 694 F.2d 923 (2d Cir. 1982). See Siemers, 243 F.R.D. at 374. This unusual decision, therefore, appears to be the first time that a jury would be required to apply the Gartenberg factors to assess the excessiveness of fees received by an advisor and evidences a marked departure from the usual practice that a judge, and not a jury, is to determine whether the subject fees are, in fact, excessive under the standard set forth in Gartenberg. See Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 487 F. Supp. 999, 1001 (S.D.N.Y.) (holding that, because a determination of the excessiveness of the fees and the corresponding remedy is equitable in nature, plaintiffs are not entitled to a jury trial), aff'd sub nom. In re Gartenberg, 636 F.2d 16 (2d Cir. 1980), cert. denied sub nom. Gartenberg v. Pollack, 451 U.S. 910 (1981). On July 5, 2007, the parties entered into a stipulation of settlement.

o. On August 29, 2006, Edward D. Jones ("Edward Jones"), various Edward Jones affiliates, and a number of individual defendants agreed to settle several class actions alleging that Defendants shoehorned as many investors as possible into a limited number of "preferred" mutual fund families in exchange for hundreds of millions of dollars in cash payments from those preferred funds but concealed the arrangement and the conflicts of interest it created from its clients. (The preferred funds included mutual funds in seven fund complexes: Lord Abbett Funds; American Funds; Federated Funds; Goldman Sachs Funds; Hartford Funds; Putnam Funds; and Van Kampen Funds.) The settlement also covered two actions originally filed in state courts that alleged the Defendants' receipt and retention of the cash payments while holding its clients' assets in trust constituted a breach of fiduciary duty. See Spahn v. Edward D. Jones & Co., No. 04 CV 00086 (E. D. Mo.) (Memorandum of Law in Support of Lead Plaintiffs' Amended Motion for An Order Preliminarily Approving Class Action Settlement, Conditionally Certifying the Settlement Class, Approving the Form and Manner of Notice, and Setting Fairness Hearing (D.I. 187)). Defendants agreed to pay $127.5 million consisting of a $55 million cash component and a $72.5 million non-cash component. See id.

p. In Gilliam v. Fidelity Management & Research Co., No 04-11600, slip op. (D. Mass. Sept. 18, 2006), plaintiffs alleged that defendants made undisclosed, improper, and excessive payments to unaffiliated broker-dealers to promote the sale of Fidelity-branded mutual funds over other funds. Plaintiffs alleged that this purported "scheme" resulted in a marked increase in fund assets, the benefits of which were wrongfully retained by the defendants and were not shared with fund investors. Based on these

allegations, plaintiffs brought claims under Sections 34(b), 36(a), 36(b), and 48(a) of the Act; Sections 206 and 215 of the Investment Advisers Act of 1940; and common law claims for breach of fiduciary duty and unjust enrichment. Defendants moved to dismiss the complaint in its entirety, including plaintiffs' claim under Section 36(b) arguing, inter alia, that the claim was improperly brought directly as a putative class action rather than derivatively on behalf of the subject funds. After an extensive analysis of the plain language, legislative history, and various decisions interpreting the scope of a cause of action brought pursuant to Section 36(b), the court concluded that Congress intended only to create a derivative, and not direct, cause of action and recommended dismissal of plaintiffs' claim. In so doing, the court acknowledged that previous decisions in the District of Massachusetts had characterized Section 36(b) claims as direct, but declined to follow such precedent based on a determination that such decisions were the result of "imprecise" findings. Moreover, the court analyzed the substantive law of the funds' states of incorporation—in this case, Massachusetts and Delaware—and found additional support for its determination that the Section 36(b) claim asserted by plaintiffs is, in fact, derivative. See id. at 23-47. The action was subsequently voluntarily dismissed with prejudice.

q. In Boyce v. AIM Management Group, Inc., No. H-04-2587, 2006 WL 4671324 (S.D. Tex. Sept. 29, 2006), plaintiffs alleged that the advisers, distributors, and directors of the AIM-branded family of funds violated Sections 34(b), 36(a), 36(b), and 48(a) of the Act; Section 215 of the Investment Advisers Act of 1940, and state law by making excessive revenue sharing payments to unaffiliated broker-dealers, which ultimately resulted in an increase in asset-based fees paid to defendants. Id. at *1. Judge Ellison dismissed the Section 36(b) claim, with leave to replead, for failure to assert that cause of action derivatively, rather than directly. Id. at *3. The court found that the source of the confusion over whether Section 36(b) provides for a direct rather than derivative right of action stems from "a statement that Supreme Court made in Kamen v. Kemper Financial Services, Inc., 500 U.S. 90 (1991)." Boyce, 2006 WL 4671324, at *3. The court noted, however, that the "more sensible interpretation is that the Court's reference to Section 36(b) as 'direct' was not intended to reverse the [Supreme Court's earlier] holding of Daily Income, but merely to emphasize that a shareholder can bring a derivative claim under Section 36(b) 'directly,' i.e., without first making a demand on the corporation. Id. (citing In re Am. Mutual Funds Fee Litig., 2005 WL 3989803, at *3 (C.D. Cal. Dec. 16, 2005)). The court thus dismissed the Section 36(b) claim with leave to replead.

Following the court's ruling on defendants' motion to dismiss, plaintiffs filed a third amended complaint, asserting their ICA Section 36(b) claim derivatively on behalf of the subject funds. See Boyce v. AIM Mgmt. Group, Inc., No. H-04-2587, 2007 WL 7117575 (S.D. Tex. Sept. 17, 2007). Defendants moved to dismiss the complaint or, alternatively, for reconsideration of the court's September 29, 2006 decision granting plaintiffs the opportunity to replead their Section 36(b) claim derivatively. Defendants argued, consistent with Judge Martini's decision in In re Lord Abbett Mutual Funds Fee Litigation, No. 04-CV-559, 2006 WL 3483946 (D.N.J. Dec. 4, 2006), that the court's previous decision dismissing state law claims as preempted under SLUSA required dismissal of the entire action, including plaintiffs' Section 36(b) claim. Defendants also argued that the previous complaint was insufficient to constitute an "action" for purposes of Section 36(b)'s one year look-back damages period because it was improperly asserted directly as a putative class action rather than derivatively on behalf of the subject funds. According to defendants, the "action," as defined by Section 36(b), was instituted once plaintiffs asserted their claim derivatively and that plaintiffs failed to allege any facts within the applicable one-year period. See Boyce, 2007 WL 7117575, at *3-6. Citing Judge Feess' decision in In re American Mutual Funds Fee Litigation, No CV 04-5593, slip op. (C.D. Cal. Jan. 17, 2007), plaintiffs argued that SLUSA did not mandate dismissal of the entire action, and that the "action" for purposes of Section 36(b)'s one-year look back provision was triggered upon the filing of the initial complaint. See Boyce, 2007 WL 7117575, at *3.

Judge Ellison rejected defendants' argument that the court's prior dismissal of plaintiffs' state law claims as preempted under SLUSA required the dismissal of the entire action, finding that "if Congress intended SLUSA to preclude both federal and state claims presented in a 'covered class action,' such indication would be apparent. It is not." Id. at *5. The court, however, agreed with defendants' interpretation of the word "action" as it relates to Section 36(b)'s one-year look back period, finding that "[n]o 'action' meeting the section 36(b) statutory provision was filed until December 7, 2006, when plaintiff filed an 'action' 'on behalf of such company.' Until that time, only a class action lawsuit—a claim not cognizable under section 36(b)—was on file." Id. at *6. Moreover, the court found that the "relation back" of amendments provision was inapplicable to cases brought pursuant to Section 36(b), holding that a rule of procedure may not be used to modify a substantive damages limitation. Id. Finally, the court held that because plaintiffs failed to plead facts alleging damages within the relevant "look-back" period, the cause of action brought pursuant

to Section 36(b) failed to state a claim, and dismissed plaintiffs' complaint with prejudice. Id. at *6-7.

r. In In re Scudder Mutual Funds Fee Litigation, No. 04 Civ. 1921, 2007 WL 2325862 (S.D.N.Y. Aug. 14, 2007), another revenue sharing action, plaintiffs alleged that Deutsche Bank and certain affiliated entities engaged in a scheme to improperly induce unaffiliated broker-dealers to steer investors towards Scudder-branded mutual funds, the result of which increased fund assets and corresponding fees. Plaintiffs further allege that several of the Trustees were current or former employees of the Investment Advisor Defendants, creating a conflict of interest between "the interest in siphoning fees from shareholders to induce brokers to sell the Funds' shares" and the interests of the fund shareholders. Id. at *2-3. According to plaintiffs, this purported "conflict" was manifested in several improper practices, including, inter alia, inappropriate revenue-sharing arrangements, so-called "soft-dollar kickbacks," and the failure to pass on the benefits of scale economies to fund shareholders. Id. at *3. Plaintiffs allege that these activities constituted violations of Sections 36(b) and 48(a) of the Act. Defendants moved to dismiss the complaint in its entirety, including plaintiffs' Section 36(b) claim, arguing that: (1) plaintiffs improperly asserted their claim directly as a putative class action rather than derivatively on behalf of the subject funds; and (2) plaintiffs' Section 36(b) allegations were insufficient to state a claim.

Judge Batts agreed and dismissed plaintiffs' Section 36(b) cause of action in its entirety with prejudice. The court first addressed defendants' argument that a Section 36(b) claim may only be brought derivatively on behalf of the funds rather than directly by fund shareholders. After analyzing the plain language of Section 36(b) and relevant case law directly on point, the court held that the text of the statute coupled with dicta from the Supreme Court's decision in Daily Income and the Second Circuit's language in Olmsted v. Pruco Life Ins. Co. of New Jersey, 283 F.3d 429 (2d Cir. 2002), "requires a ruling that Section 36(b) provides for derivative, not direct, suits." In re Scudder, 2007 WL 2325862, at *13. Moreover, the court also found that the allegations in the complaint were insufficient to state a claim under Section 36(b). Citing Gartenberg v. Merrill Lynch Asset Management, Inc., 694 F.2d 923 (2d Cir. 1982), the court analyzed each of the six relevant factors in turn, and concluded that plaintiffs' complaint failed to state a claim. Specifically, the court found that plaintiffs' bald allegations that: (1) the nature and quality of services deteriorated because several high-level employees departed from the Scudder complex; (2) the purported soft-dollar kickbacks were an improper

use of fund assets; (3) the benefits of economies of scale were improperly retained by defendants and not passed on to fund investors; and (4) the funds' Trustees lacked independence and conscientiousness merely because two of the Trustees were allegedly employees of the defendants, lacked the requisite specificity to state a claim under Section 36(b). In re Scudder, 2007 WL 2325862, at *13-18.

s. In Alexander v. Allianz Dresdner Asset Management of America Holding, Inc., 509 F. Supp. 2d 190 (D. Conn. 2007), plaintiffs alleged that defendants used assets from the PIMCO-branded family of mutual funds to make improper "shelf-space" payments to unaffiliated broker-dealers in exchange for promoting the funds to unwitting investors. Id. at 193. Plaintiffs alleged that these payments violated: (1) Sections 34(b), 36(a), 36(b) and 48(a) of the ICA; (2) Section 215 of the Investment Advisers Act of 1940; and (3) various claims under state common law, including breach of fiduciary duty, aiding and abetting breach of fiduciary duty, and unjust enrichment. Id. at 193-94. Defendants moved to dismiss the complaint in its entirety, including plaintiffs' Section 36(b) claim. According to the defendants, plaintiffs' allegations that defendants breached their fiduciary duty by "improperly charging investors in the Funds purported Rule 12b-1 marketing fees" and by "improperly inflating management fees by shifting expenses from the Investment Advisers to the Funds' investors without a corresponding reduction in the management fees" was insufficient to state a viable claim under Section 36(b). The court agreed. Citing the Second Circuit's decisions in Gartenberg and Eaton Vance, the court found that plaintiffs' allegations that the defendants used fees for an improper purpose was insufficient to state a cause of action pursuant to Section 36(b). See Allianz Dresdner Asset Mgmt., 509 F. Supp. 2d at 195-96.

t. In Hoffman v. UBS-AG, 591 F. Supp. 2d 522 (S.D.N.Y. 2008), investors in various UBS mutual funds brought a putative class action involving revenue sharing against, inter alia, the investment adviser and distributor of the UBS proprietary funds. Plaintiffs alleged violations of various provisions of the Act, the Securities Act, and the Securities Exchange Act. With respect to the Act, plaintiffs asserted claims under Section 36(b) both directly and derivatively. Defendants moved to dismiss both. The court as an initial matter adopted Judge Batts' analysis in In re Scudder to conclude that Section 36(b) provides for derivative, not direct, suits, and granted defendants' motion as to the direct claim. See Hoffman, 591 F. Supp. 2d at 538. Turning to the derivative claims, Judge Sand held that plaintiffs had not pled facts relating to the Gartenberg factors as required under Second Circuit

jurisprudence. Judge Sand held that allegations of underperformance alone are not sufficient; the complaint did not allege sufficient information for the court to determine the profitability of defendants, "which is a prerequisite to establishing [the profitability] factor"; plaintiffs' allegations concerning fall-out benefits referred to the propriety of the fees, not the amount charged; plaintiffs' allegations did not satisfy the economies of scale factor; plaintiffs did not make appropriate comparisons to other mutual funds; and plaintiffs' reference to statements of SEC officials about mutual fund directors generally and to a Forbes magazine article about the UBS board of directors were insufficient to challenge the presumption of disinterestedness under the Act. Id. at 538-41.

Rule 12b-1 Plans / Funds Closed to New Investors

u. In Korland v. Capital Research and Management Company, No. CV-08-4020, 2006 WL 936612 (C.D. Cal. Feb. 10, 2009), plaintiff, a shareholder in the $100 billion EuroPacific Growth Fund (the "Fund" or "EUPAC") challenged the Fund's payment of post-sale Rule 12b-1 fees to broker-dealers for servicing Fund shareholders. Plaintiff claimed that the Rule 12b-1 fees paid by EUPAC were improper and therefore *per se* excessive in violation of Sections 36(b) and 48(a) of the Act. Rule 12b-1, enacted by the SEC in 1980, provides a mechanism by which a mutual fund may use its assets to pay for activities primarily intended to result in the sale of fund shares. In response to this Rule, EUPAC, like many mutual funds, enacted a "Rule 12b-1 plan" which allowed the fund to use fund fees to pay for distribution, as well as for activities relating to post-sale shareholder services. Plaintiff alleged that this latter use—payments to broker-dealers for ongoing service advice rendered by individual financial consultants—was an activity which did not "result in the sale of fund shares" and was therefore *per se* illegal.

Defendants moved to dismiss the complaint, arguing that there is no such thing as a *per se* violation of Section 36(b) and that the plaintiff failed to state a claim under the six-factor Gartenberg test which governs mutual fund excessive fee actions. Defendants highlighted for the court the 28-year history of Rule 12b-1, and the fact that the SEC had recognized that post-sale shareholder services encourages mutual fund shareholders to purchase new or additional fund shares.

The court (Feess, D.J.) held that under applicable case law, it was insufficient under Section 36(b) for plaintiff to plead that an expenditure under Rule 12b-1 was "*per se*" unlawful or

unauthorized; "more must be alleged." Judge Feess went on to state that the mere allegation "that fees are used for an improper purpose" is also not sufficient to state a Section 36(b) claim. Judge Feess explained that if plaintiff chooses to replead, plaintiff must plead detailed Gartenberg-style allegations. Lastly, Judge Feess held that there is no private right of action for controlling person liability under Section 48(a) of the ICA, and dismissed that claim with prejudice.

v. In Mintz v. Baron, No. 05 Civ. 4904, 2006 WL 2707338 (S.D.N.Y. Sept. 19, 2006), plaintiffs, shareholders in two Baron-branded mutual funds, brought claims under Section 36(b) of the Act, as well as a state law claim for breach of fiduciary duty, against the funds' investment adviser, distributor, and a select group of trustees of the Baron funds. Plaintiffs' claims related to certain distribution payments made pursuant to Rule 12b-1 that were charged to funds that were closed to new investors. According to plaintiffs, once the funds at issue closed to new investors, the distribution and service fees far exceeded the minimal costs actually incurred, and defendants' receipt of those fees constituted a breach of their fiduciary duties under Section 36(b). See id. at *2. Defendants moved to dismiss. With respect to the claim under Section 36(b), defendants argued that the allegations pertaining to the complained-of conduct (i.e., the receipt of Rule 12b-1 fees despite the fact that the funds at issue were closed) failed to state a claim "because the Funds' prospectus demonstrates that they are open to additional investments by certain categories of investors and that the relevant 12b-1 plan permits payment of administrative, as well as marketing expenses." Id. at *4. Citing Gartenberg, the court analyzed each of the relevant factors in turn and concluded that plaintiffs' allegations were "barely" sufficient to survive a motion to dismiss. Id. at *4.

The court, however, made two additional rulings with respect to Section 36(b). First, the court dismissed the Section 36(b) claim as to the investment adviser defendant because Section 36(b) only applies to recipients of the fees in question, which plaintiffs did not allege. See id. at *3. Second, the court noted that plaintiffs improperly asserted their Section 36(b) claim directly on behalf of a putative class of shareholders rather than derivatively on behalf of the subject funds. Accordingly, the court directed plaintiffs to either replead their Section 36(b) claim derivatively or, alternatively, to "show cause in writing as to why such amendment is not necessary." Id. at *4.

Following the court's ruling on defendants' motion to dismiss, plaintiffs filed a second amended complaint, asserting substantially

similar allegations. Again, defendants moved to dismiss, arguing that the complaint failed to adequately allege a violation of Section 36(b), as set forth by the Second Circuit in Gartenberg and reiterated in Amron. The court agreed, noting that the Supreme Court's decision in Twombly v. Bell Atlantic, 550 U.S. 544 (2007), required a detailed application and examination of each of the Gartenberg factors. After reviewing each factor in turn, the court found the amended complaint inadequate, holding that "[i]n the absence of facts sufficient to provide context for any Gartenberg factor that would support Plaintiffs' claim of excessive fees, the Amended Complaint fails to state plausibly a claim under Section 36(b)." See Mintz v. Baron, No. 05 Civ. 4904, 2009 WL 735140, at *4 (S.D.N.Y. Mar. 20, 2009).

w. In ING Principal Protection Funds Derivative Litigation, 369 F. Supp. 2d 163 (D. Mass. 2005), Judge Tauro adopted the six Gartenberg factors and applied the Gartenberg standard to plaintiffs' claim under Section 36(b). Plaintiffs were shareholders in three principal protection funds ("PPFs"), a popular investment vehicle for investors seeking protection of principal with some opportunity for growth. There are three distinct time periods applicable to each PPF: an "Offering Phase," during which shares of the fund are offered to prospective investors; a "Guarantee Period," a five-year period during which shares are not offered to new investors; and an "Index Plus LargeCap Period," during which existing shareholders may purchase additional shares of the fund. Thus, by design, the PPFs close to new investors after the Offering Phase.

Each PPF has several classes of shares with different fee structures. For example, Class A shares include an up-front sales charge but do not carry any Rule 12b-1 distribution fees. Class B shares do not have an up-front sales charge, but carry a distribution fee at an annual rate of 0.75% of the value of the average daily net assets of Class B shares. (All shareholders pay to the distributor an annual "service fee" equal to .25% of the average daily net assets of the fund.) Thus, purchasers of Class B shares finance the commissions and other distribution expenses relating to their shares, rather than paying for the expenses up front like Class A shareholders. The distributor of the Class B shares is reimbursed over time for the sales charge paid to the broker at the time the sale is made.

Plaintiffs alleged that the defendants breached their fiduciary duties under Section 36(b) because the distribution fees charged during the Guarantee Period materially exceeded the distributor's expenses during that period, when the PPFs were closed to new

investors. Plaintiffs also alleged that the advisory fees charged to the PPFs were excessive.

The court explicitly identified the six Gartenberg factors and stated, "Mutual funds may not charge fees, of any kind, that are so disproportionately large that they bear no reasonable relationship to the services *actually provided*." Id. at 168 (quotation removed) (emphasis in original). "Accordingly, to state a claim that an excessive fee violates the fiduciary duties imposed by section 36(b) of the ICA, a complaint must contain 'a short and plain statement' showing that the fee charged is so large that it bears no reasonable relationship to the relevant services actually provided." Id. (quoting Fed. R. Civ. P. 8(a)(3)).

The court found that plaintiffs focused entirely on the distribution services during the Guarantee Period and made no allegations concerning the relationship between the sales-related services actually provided during the Offering Phase and the .75% distribution fees at issue. Id. at 168-69. "At a minimum, Plaintiffs must also allege that the distribution fees are disproportionate and unrelated to the sales-related services actually provided when shares of the funds were marketed and sold to the general public." Id. at 169. The court also found that plaintiffs made no allegation that the .25% service fee charged to all shareholders exceeded the expenses associated with maintaining shareholder accounts. The court, thus, dismissed the claims concerning Rule 12b-1 fees. Id.

With respect to advisory fees, however, the court held, with no analysis, that the complaint "alleged sufficient facts to state a claim that these fees are so disproportionately large that they bear no reasonable relationship to the advisory services actually rendered on behalf of the funds." Id.[11]

x. In Yameen v. Eaton Vance Distributors, Inc., 394 F. Supp. 2d 350 (D. Mass. 2005), plaintiff brought claims under Section 36(a) and 36(b) of the Act, as well as breach of fiduciary duty under state law. Defendants moved to dismiss the complaint for failure to state a claim. The plaintiff elected not to oppose the motion to

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[11] The court also dismissed plaintiffs' state law claims against the directors, which were added in an amended complaint, because plaintiffs' failed to make a demand on the board of directors as required by Massachusetts' "universal demand" statute. See id. at 170-71 (discussing MASS. GEN. LAWS ch. 156D, § 7.42.). Further, the court dismissed the state law claims against the advisers and distributor, which predated the "universal demand" statute, because the plaintiffs failed to make a pre-suit demand on the Board of Trustees, a majority of whom were considered independent under both the ICA and Massachusetts law. Id. at 171-72.

dismiss the Section 36(a) and state law claims, leaving only the Section 36(b) claim for the court's consideration. The court granted the motion to dismiss.

The Section 36(b) claim centered on Rule 12b-1 fees charged to a closed fund. Plaintiff alleged that once the fund in question closed, the distribution and services fees greatly exceeded the minimal costs actually being incurred, and that defendants' receipt of those fees breached their fiduciary duty under Section 36(b). Id. at 353. After setting out the Gartenberg factors to be considered when evaluating a Section 36(b) claim, the court found that plaintiff's allegation put at issue only one Gartenberg factor: the independence and conscientiousness of the funds' trustees. Specifically, plaintiff alleged that the trustees failed to consider the fact that the fund was closed to investors when they approved the fees at meetings from 2001-2004. Id. at 355. The court held that plaintiff failed to demonstrate "any substantive connection between the Trustees' fiduciary duties and the allegedly excessive fees," or provide any facts suggesting that the trustees failed to follow the advice of counsel or "were less than procedurally conscientious in making their decision to continue the fees." Id. at 356-57.

The court stated the crux of plaintiff's claim was "that the fees were *per se* excessive because they exceed the *de minimis* ongoing sales expenses of a closed Fund." Id. at 357. The court adopted Judge Tauro's reasoning in In re ING Principal Protection Funds Derivative Litigation ("ING"), stating that the SEC has interpreted Rule 12b-1 to "allow mutual funds to compensate companies for past distribution services." Yameen, 394 F. Supp. 2d at 357. Plaintiff argued that ING was wrongly decided in that Judge Tauro should have modified the Gartenberg test to accommodate the requirement under Rule 12b-1 that there be a "'reasonable likelihood that the fee plan will benefit the fund and its shareholders.'" Id. (quoting Rule 12b-1). According to plaintiff's reading of Rule 12b-1, fees must benefit shareholders in the future, "and their legality should therefore be judged based on the benefits shareholders receive during the period of time fees are being paid." Id. The court disagreed, noting that Rule 12b-1 and NASD Rule 2830 are "specifically designed to allow mutual funds to continue paying sales charges after a fund has closed to new investors." Id. Furthermore, the court opined, the Gartenberg test does take into account Rule 12b-1's requirement that fees ultimately benefit shareholders. Yameen, 394 F. Supp. 2d at 357-58. The court held that the Gartenberg test adequately accommodates evaluation of both "the need for Fund directors 'to make business judgments to use fund assets for distribution' and the need to ensure that

directors are 'free of undue management influence and have carefully considered all relevant factors.'" Yameen, 394 F. Supp. 2d at 358 (quoting Bearing of Distrib. Expenses by Mutual Funds, SEC Rel. 6254, 1980 WL 20761, at *1 (Oct. 28, 1990)).

y. In Pfeiffer v. Integrated Fund Services, Inc., 371 F. Supp. 2d 502 (S.D.N.Y. 2005), plaintiff brought suit against Integrated Fund Services and two officers of Integrated who also serve as officers of the Bjurman, Barry Micro-Cap Growth Fund. Integrated was compensated for a range of administrative and other services performed on behalf of the Fund, as well as various transfer agent and shareholder servicing functions, pursuant to two agreements. Bjurman, Barry & Associates is the fund's investment adviser. The fund closed to new investors in May 2003. Id. at 503-04.

Plaintiff alleged that Integrated violated Section 36(b) of the Act by receiving, or by approving the receipt of, "grossly inflated" administrative and transfer agent fees from the fund. Id. at 505. Plaintiff contended that Integrated's compensation under the agreements increased substantially as the fund's asset base increased, despite the fact that the fund was closed to new investors. Plaintiff sought to recover the "improper administrative fees, transfer agent fees and any other expenses paid by the Fund to Integrated." Id.

Defendants moved for judgment on the pleadings, arguing that Section 36 of the Act solely addresses fees for advisory services and that a party must either be an investment adviser or an affiliated party thereof in order to be liable under Section 36(b). Id. After discussing Sections 36(a) and 36(b), as well as the definition of "affiliated person" under the Act, the court held that, reading Section 36(a) and 36(b) together, "a security holder may sue an investment adviser, a person affiliated with an investment adviser, or one of those persons enumerated in [Section 36(a)] who has a fiduciary duty with respect to the receipt of compensation for services or payments of a material nature paid by a registered investment company or its security holders." Id. at 507.

The court found that the phrase "affiliated person of such investment adviser" pertained to affiliates of Bjurman, Barry, and that to qualify as an "affiliated person" of Bjurman, Barry, a defendant would need to be a shareholder of or otherwise affiliated with Bjurman, Barry. Id. at 509. The court held that plaintiff alleged no facts giving Integrated fair notice that his claim rested on their satisfying the "affiliated person of such investment adviser" prong of Section 36(b). Id. Nor did plaintiff allege that Integrated was a person enumerated under Section 36(a), thus

depriving Integrated of fair notice that plaintiff's claim rested on that prong. Id. Moreover, the claims against the officers failed because, while the officers were enumerated persons under Section 36(a), Plaintiff failed to allege that either officer received administrative or transfer agent fees. Id. The court granted defendants' motion for judgment on the pleadings in its entirety. Id. at 510.

z. In Zucker v. AIM Advisors, 371 F. Supp. 2d 845 (S.D. Tex. 2005) and Lieber v. INVESCO Funds Group, Inc., 371 F. Supp. 2d 852 (S.D. Tex. 2005), the court, in actions against the adviser and trustees of several funds, addressed a variety of these issues on motions to dismiss. Plaintiffs alleged that the advisers breached their fiduciary duty under Section 36(b) of the 1940 Act by collecting excessive marketing, distribution, and other advisory fees from the funds after the funds were closed to new investors. Plaintiffs also brought state law claims for breach of fiduciary duty and corporate waste. The court granted defendants' motions to dismiss the Section 36(b) claims against the advisers because the advisers were not the actual recipients of any Rule 12b-1 fees from or in connection with the funds. The court went on to grant plaintiffs' motions to add the distributor as a defendant and rejected defendants' arguments that compliance with NASD Rule 2830 constituted a complete defense to Section 36(b) and state law claims of fiduciary duty and/or corporate waste. Finally, the court granted defendants' motions to dismiss plaintiffs' claims brought on behalf of funds in which they were not shareholders.

aa. In Pfeiffer v. Bjurman, Barry & Associates, No. 03 Civ. 9741, 2004 WL 1903075 (S.D.N.Y. Aug. 26, 2004), the court denied a motion to dismiss an action alleging a violation of Section 36(b) where Rule 12b-1 fees continued to be charged after a fund closed. In Pfeiffer, the court held that plaintiff had met its pleading burden by alleging that fees charged after the fund closed were not reasonably related to the services rendered to the fund, in light of the fund's 43% increase in value over a few-months period, resulting in dramatically higher Rule 12b-1 fee totals. The court rejected several decisions in which courts dismissed a Section 36(b) claim for failure to state a claim and held that it was "unnecessary for the plaintiff to set forth evidentiary details to support this allegation, or to support those elements of the Gartenberg test that may apply to promotion, distribution and service fees." Id. at *4.

After several years of discovery, defendant subsequently moved for summary judgment, arguing that the Rule 12b-1 fees at issue were not paid to defendant for marketing and distribution, but were

instead service fees paid by the fund directly to broker-dealers. See Pfeiffer v. Bjurman, Barry & Assoc., No. 03 Civ. 9741, 2006 WL 497776, at *1 (S.D.N.Y. Mar. 2, 2006). Defendant argued that because it was not a "recipient" of the subject fees, it could not be held liable under Section 36(b), which limits liability to those who actually receive purportedly excessive compensation or other payments. Judge Cote agreed, finding that of those courts that have previously addressed the issue of what constitutes "receipt" of payments under Section 36(b), all have limited claims to those "parties that have potentially benefited from the lack of arm's-length bargaining," imposing liability only with respect to "those payments that accrue to an advisor or its affiliates." Id. at *4. The court found plaintiff's arguments unavailing, holding that even serving as a pass-through entity for Rule 12b-1 payments does not constitute "receipt" under the Act and therefore granted defendant's motion for summary judgment. See id. at *5-6.

bb. See also Zucker v. Federated Shareholder Svcs. Co., No. 2:06cv241, 2007 WL 709305 (W.D. Pa. Mar. 5, 2007) (dismissing plaintiffs' Section 36(b) claim pertaining to the improper receipt of redemption, transfer agency, and other fees charged to shareholders in a closed fund within the Federated mutual fund complex for: (1) failure to assert the claim derivatively on behalf of the subject fund; and (2) failing to allege that several defendants were recipients of the subject fees).

cc. In Curran v. Principal Management Corp., No. 4:09-cv-433, 2010 WL 2889752 (S.D. Iowa June 8, 2010), investors in two "funds of funds" (i.e., mutual funds that invest in other mutual funds), alleged that defendants violated Section 36(b) in charging excessive advisory fees, receiving excessive profits due to economies of scale, and with regard to excessive Rule 12b-1 fees (counts I, II and III, respectively). Notably, plaintiffs brought these claims on behalf of the funds in which they owned shares (i.e., the funds of funds), and the underlying funds which those funds invested in. The "funds of funds" and the underlying funds were all part of the Principal fund complex.

With regard to plaintiffs' Rule 12b-1 claim, the court stated that plaintiffs "have met their burden by alleging that fees collected by [the distributor] for its distribution services surpassed the value of those services, and that the manner in which those fees were assessed did not correspond to the type of services performed but, rather, resemble fees collected for advisory services." Id. at *11. Thus, noting that defendants' arguments were largely factual in nature, the court concluded that "the allegations set forth in Count III are sufficient to raise an inference that the distribution fees

collected by [the distributor] were additional and excessive compensation for advisory services subject to a § 36(b) claim." Id.

On May 17, 2013, the parties alerted the court that the surviving portion of the action had settled. The court approved the parties' settlement on June 12, 2013, and dismissed the action with prejudice.

dd. In a different approach to asserting liability in connection with the payment of Rule 12b-1 fees, the plaintiff in Smith v. Franklin/Templeton Distributors, Inc., No. C-09-4775, 2010 WL 3248644 (N.D. Cal. June 8, 2010), alleged that Franklin/Templeton Fund Distributors ("FTD"), the principal underwriter and distributor of Franklin Custodian Funds (the "Trust"), and certain members of the board of trustees of the Trust, violated Section 47(b) of the Act by paying Rule 12b-1 fees to broker-dealers. Section 47(b) makes unenforceable by either party a contract "that is made, or whose performance involves, a violation of [the Act], or of any rule, regulation, or order thereunder." 15 U.S.C. § 80a-46(b)(1). Plaintiff contended that the Rule 12b-1 fees paid were asset-based compensation prohibited by Section 202 of the IAA and, thus, the distribution plans pursuant to which the fees were paid were unenforceable under Section 47(b).

Defendants moved to dismiss the complaint, arguing that Section 47(b) is strictly a remedy section; a plaintiff must allege a viable predicate violation in connection with Section 47(b). The court agreed with defendants, holding that "a plaintiff can seek relief under § 47(b) only by asserting a violation of some other section of the ICA." Franklin/Templeton, 2010 WL 2348644, at *7 (citing cases). "The court finds no language in ICA § 47(b) sufficient to create a private right of action under that statute, absent a showing of some other violation of the ICA." Id. Nor, held the court, can a violation of the IAA be the predicate for the Section 47(b) claim, as "[Section] 47(b) applies only to a contract that is made, or whose performance involves, a violation of the ICA." Id. at *8 (quotations omitted). The court dismissed the action with leave to replead. Id.

Plaintiff subsequently filed an amended complaint in which he asserted a claim for "contract voiding" pursuant to Section 47(b). In his complaint, Plaintiff asserted that the Trust "seeks a declaration that the contractual obligation to make payments of Trust assets in the form of asset-based compensation to broker-dealers holding Trust shares in brokerage account [sic] violates the Trustees' duties under Section 36(a) of the ICA and Rule 38a-1 to avoid improper use of Trust assets," and alleged that "due to the

> violation of core provisions of the ICA, Section 36(a) and Rule 38a-1 . . . that require proper and lawful use of Trust assets, the Trust seeks to have its own contractual obligations deemed to be void by reason of Section 47(b), in an action maintained under Section 47(b)." Smith v. Franklin/Templeton Distribs., Inc., No. C 09-4775, 2010 WL 4286326, at *1 (N.D. Cal. Oct. 22, 2010).
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> Defendants again moved to dismiss for failure to state a claim, which the court granted before a scheduled hearing on the motion. The court held that plaintiff's amended complaint failed to allege facts sufficient to show a predicate violation of either Section 36(a) or Rule 38a-1. Id. at *2. The court held that neither Section 36(a) nor Rule 38a-1 provide an express or implied private right of action. Nor does Section 36(a) create a federal fiduciary duty or regulate the improper use of Trust assets, or provide a right of action for a claim for breach thereof. Id. Similarly, the court held that "Rule 38a-1 does not impose on funds a duty to assure that broker-dealers comply with registration requirements, but rather simply requires funds to adopt and implement compliance programs that are reasonably designed to prevent violation of the federal securities laws." Id. at *3. As such, plaintiff did not plead facts sufficient to show any violation of Rule 38a-1.
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> The court dismissed the federal claim in the amended complaint without leave to amend. The court declined to exercise supplemental jurisdiction over the state law claims and dismissed those claims without prejudice to refiling in state court. Id.

2. Market Timing and Late Trading

Within months of the NYAG's allegations of market timing and late trading that implicated some of the best known fund families, private plaintiffs filed over four hundred lawsuits in state and federal courts around the country alleging improper market timing and late trading in mutual funds. The lawsuits—which include both derivative actions on behalf of the funds at issue and class actions on behalf of individual fund shareholders—assert claims under the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, the Act, and common law. In February 2004, the Judicial Panel on Multidistrict Litigation centralized all of the federal actions before four judges in the U.S. District Court for the District of Maryland, with separate sub-tracks for each of the nineteen fund families involved. Subsequent to consolidation, plaintiffs amended their complaints to add as defendants several broker-dealers who allegedly market timed the mutual funds on behalf of their clients.

Since market timing generally is not prohibited by federal or state law, plaintiffs generally relied on theories based on misleading disclosures or non-disclosures in fund prospectuses, or on breach of fiduciary duty theories, to assert claims based

on allegations lifted from the NYAG's complaint against Canary. Plaintiffs bring a variety of claims alleging that the funds' prospectuses misled shareholders by suggesting that the funds prohibited or discouraged market timing and by failing to disclose the allegedly improper market timing arrangements.

> (1) Plaintiffs generally allege that the mutual funds entered into undisclosed agreements with select investors pursuant to which the investors received special trading privileges in return for parking the monies in fee-generating funds and making substantial long-term investments of sticky assets in related funds. Plaintiffs allege that the existence of these agreements rendered false or misleading representations in the funds' prospectuses regarding: (1) the process for pricing shares and processing orders; (2) the existence or enforcement of policies that prohibit or discourage timing or safeguard investors against the harmful effects of timing; and (3) the nature of the investment in the funds as not for use as short-term investment vehicles.
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> (2) Plaintiffs also allege that the prospectuses were misleading because they failed to disclose: (1) the existence of market timing agreements and trading conducted pursuant to those agreements; (2) the selective enforcement of policies against frequent trading and selective waivers of redemption fees; (3) the practice of permitting select investors to engage in market timing activities; and (4) the substantial compensation to the fund advisors flowing from the secret agreements.
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> (3) Plaintiffs also bring a series of claims on the basis of theories that defendants violated duties of care, loyalty, and candor, or other specific statutory fiduciary obligations, by advancing their own interests over those of the long term investors, and by permitting and benefiting from the alleged trading activities.
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> (4) Plaintiffs also allege that defendants advanced their own interests, and those of the select shareholders, in exchange for the investment of sticky assets, which generated increased fees and other remuneration for the mutual fund managers and advisors while the ordinary shareholders suffered dilution of fund returns and other injuries as a result of the trading activities.
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> (5) Plaintiffs allege that the market timing activities harmed long term investors because the arbitrage profits diluted their returns by removing daily profits from the fund, and even magnified losses in a down market because the timer essentially sells short and thus exacerbates the ordinary shareholders' losses by further reducing the next day's NAV.
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> (6) Plaintiffs also allege that the rapid trading in and out of funds increases transaction costs imposed on ordinary fund shareholders, disrupts the fund manager's strategy, and may cause the recognition of

taxable capital gains at undesirable times, or force disadvantageous sales of fund holdings in down markets.

Although the exact nature of the relief varies somewhat, depending on whether the complaint is styled as a derivative action or class action, or on the nature of the alleged claims, for the most part the complaints seek unspecified damages and/or rescission of the advisory contracts, including return of advisory fees.

Plaintiffs invoke the following sections of the Act in making their claims.[12]

(1) Disclosure Claims Under Sections 34(b) and 20(a): Shareholders have sued fund advisors, investment companies, and the funds under Section 34(b), which makes it unlawful to file a prospectus or registration statement containing a misleading statement or omission. Shareholders also allege that, by failing to disclose fee-generating market timing agreements, the proxy statements circulated to obtain approval of the advisory contracts violated Section 15(a), which requires full disclosure of all compensation paid pursuant to that contract, and thus also violated Section 20(a), which requires that all proxy statements comply with the rules promulgated by the SEC.

(2) Breach of Fiduciary Duty/Invalid Advisory Agreement Claims Under Sections 10(a), 12(b), 15(c), 36(a) and 36(b): Plaintiffs allege that the investment adviser breached fiduciary duties to shareholders by engaging in schemes for their own financial benefit, failing to reveal material facts about the true value and performance of the funds, permitting select customers to make engage in market timing activities, and/or by failing to disclose those practices, in violation of Sections 36(a) and 36(b). Other shareholders, using Section 36(b) as the basis for a private right of action, have brought actions against the fund's investment advisor derivatively on behalf of the funds alleging that the advisor violated Sections 10(a), 12(b) and 15(c) relating to director independence, distribution, and approval of advisory agreements.

(3) Unfair Pricing Claims Under Sections 22 and 37: Shareholders have sued investment companies, parents, and fund advisors under Section 37 of the Act, which criminalizes the theft and embezzlement of investment company assets. Shareholders also allege that defendants violated Section 22(d) of the Act, which requires fair pricing of mutual funds. These shareholders allege that defendants violated these sections by failing to properly value the funds in light of their knowledge that

[12] Relying on repetitive theories, plaintiffs also allege claims under a variety of federal and state statutes and common law, including the Securities Act of 1933, the Securities Exchange Act of 1934, the Racketeer Influenced and Corrupt Organization Act ("RICO"), the Employee Retirement Income Security Act of 1934 ("ERISA"), and state laws of fiduciary duty, contract, and conspiracy.

market timing and late trading by select investors impacted the value of the funds and decreased the value of ordinary investors' investments.

(4) Rescission Claim Under Section 215 of the Investment Advisers Act of 1940: Shareholders have sued investment advisors under Section 215 of the Investment Advisers Act of 1940, which provides that any advisory agreement made in violation of the Investment Advisers Act of 1940 is void, on the grounds that the defendants engaged in a fraud in violation of fiduciary standards set forth in Section 206 of the Investment Advisers Act of 1940. Plaintiffs theorize that the advisors breached their fiduciary duties by engaging in a scheme to permit select investors to engage in market timing, disseminating misleading information in the fund prospectuses, and failing to act in conformance with their internal policies.

There are numerous arguments for dismissing these actions, including:

(1) Absence of a material misstatement: The prospectus disclosures cited by plaintiffs generally contain significant qualifiers that leave the funds discretion to prevent market timing in their funds. For example, many of the quoted passages state that the company "may" penalize investors for such trading. Accordingly, plaintiffs may have trouble making the necessary showing that the fund prospectuses were misleading.

(2) Failure to establish that fees are "excessive" in violation of Section 36(b): It is unlikely that the receipt of additional advisory fees flowing from the investment of "sticky assets" is sufficiently large to render the advisor's overall fees disproportionate to the services rendered.

(3) Improper defendants: Under Section 36(b), damages can be assessed only against recipients of advisory compensation or other payments, which should preclude claims for damages against fund directors and other defendants who did not receive advisory compensation from the funds.

(4) No private right of action under any section of the Act other than the express right in Section 36(b).

(5) Failure to bring the action derivatively on behalf of the fund rather than directly.

(6) Demand not excused as futile.

On August 25, 2005, Judge Motz in the District of Maryland issued the first of the decisions on motions to dismiss in the numerous tracks and sub-tracks in the market timing and late trading multi-district litigation. See In re Mutual Funds Inv. Litig. (In re Janus Subtrack Investor Class Op.), 384 F. Supp. 2d 845 (D. Md. 2005) ("Market Timing Class Op."); In re Mutual Funds Inv. Litig. (In re Janus Subtrack Fund Derivative Op.), 384 F. Supp. 2d 873 (D. Md. 2005) ("Market

Timing Derivative Op."). With respect to the investor class actions, the court held that plaintiffs' allegations that: (1) management fees, which were based on the amount of funds under management, were increased excessively by late trades and market timed transactions that increased the funds under management; (2) the influx of funds from late trades and market-timed transactions excessively increased fees paid by funds for distribution of shares; and (3) the management fees paid as a result of the deposit of so-called "sticky assets" that would "sit quietly, in low-risk money-market or government bond funds" were entirely unearned, stated a claim under Section 36(b). Market Timing Class Op., 384 F. Supp. 2d at 867-68.[13]

On May 30, 2006, Judge Motz issued a series of letter opinions in the market timing and late trading multi-district litigation discussing the scope of liability under Section 36(b). See In re Mutual Funds Inv. Litig. (In re Van Kampen Funds Sub-Track), No. MDL-15863, 2006 WL 1581176 (D. Md. May 30, 2006); In re Mutual Funds Inv. Litig. (In re AIM/Invesco Sub-Track), No. MDL-15864, 2006 WL 1581193 (D. Md. May 30, 2006). With respect to the Van Kampen sub-track, defendants' sought reconsideration of the court's March 1, 2006 order permitting plaintiff to pursue its claims under Sections 36(b) and 48(a), arguing that plaintiff had failed to allege facts sufficient to sustain a claim within the one year look-back period applicable to claims brought under Section 36(b). The court agreed, finding that the complaint did not include any allegations within the applicable time period and dismissed plaintiff's claims under the Act accordingly. See In re Van Kampen, 2006 WL 1581176, at *1-2.

On the same day as Van Kampen, Judge Motz dismissed plaintiffs' claims brought under Sections 36(b) and 48(a) in the AIM/Invesco sub-track, finding that plaintiffs failed to allege that defendants "actually received the purportedly excessive compensation" at issue and held that defendants could not, therefore, be subject to secondary liability under Section 48(a). AIM/Invesco Sub-Track, 2006 WL 1581193, at *1.[14]

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[13] Following Judge Motz's decision, a number of additional rulings adopting the reasoning of the Janus opinions were issued. See, e.g., In re Mutual Funds Inv. Litig. (In re Excelsior), No. 04-MD-15861, 2005 U.S. Dist. LEXIS 27611 (D. Md. Nov. 4, 2005); In re Mutual Funds Inv. Litig. (In re Scudder), No. 04-MD-15861, 2005 WL 3095140 (D. Md. Nov. 3, 2005), recons. granted in part & denied in part, 437 F. Supp. 2d 449 (D. Md. 2006); In re Mutual Funds Inv. Litig. (In re Strong), No. 04-MD-15864, 2005 U.S. Dist. LEXIS 27614 (D. Md. Nov. 3, 2005); In re Mutual Funds Inv. Litig. (In re Federated), No. 04-MD-15861, 2005 WL 3038695 (D. Md. Nov. 3, 2005).

[14] Subsequent to his May 30, 2006 decisions in Van Kampen and AIM/Invesco Sub-Track, Judge Motz issued several additional rulings adopting the reasoning of the these opinions in other sub-tracks of the MDL. See, e.g., In re Mutual Funds Inv. Litig. (In re PIMCO Fund Derivative Sub-Track), No. 04-md-15863, slip op. (D. Md. June 14, 2006); In re Mutual Funds Inv. Litig. (In re Invesco Fund Derivative Sub-Track), No. 04-md-15864, slip op. (D. Md. June 14, 2006); In re Mutual Funds Inv. Litig. (In re One Group Fund Derivative Sub-Track), No. 04-md-15863-05, slip op. (D. Md. June 14, 2006); In re Mutual Funds Inv. Litig. (In re Putnam Fund Derivative Sub-Track), No. 04-md-15863,

Recently, Judge Motz issued several additional letter opinions dismissing plaintiffs' Section 36(b) claims against the trustees of several funds. According to the court, plaintiffs failed to allege that that the trustees were recipients of the subject fees, as required by Section 36(b), rendering the allegations "insufficient to support a viable 36(b) claim." In re Mutual Funds Inv. Litig. (In re RS Investment Sub-Track), No. 04-md-15863, slip op. at *2 (D. Md. July 7, 2006); In re Mutual Funds Inv. Litig. (In re Alger Sub-Track), No. 04-md-15863, slip op. at *2 (D. Md. July 7, 2006).

On December 28, 2006, Judge Motz issued an Order entering final judgment dismissing claims in the Market Timing MDL against William Wolverton, former general counsel of Putnam. Plaintiffs had alleged that Wolverton violated Section 36(b) of the Act in that as general counsel of Putnam he failed to stop market timing activities and was a recipient of asset managements fees by virtue of receiving his salary. Plaintiffs also alleged that Wolverton violated Section 48 of the Act as a control person in that he caused to be done through others what would be unlawful under the Act for he himself to do. Judge Motz agreed with Wolverton that his salary did not constitute the receipt of fees contemplated by Congress in connection with Section 36(b) and, thus, there was no Section 36(b) violation. Further, without an underlying violation of Section 36(b), there could be no violation of Section 48. See Zuber v. Putnam Inv. Mgmt. LLC, et al., No. 04-cv-564, slip op. (D. Md. Dec. 28, 2006) (D.I. 2298-2).

On December 30, 2008, Judge Motz issued a decision in the Janus and Putnam sub-tracks denying defendants' motion for summary judgment on the Section 36(b) claims. See In re Mutual Funds Inv. Litig., 590 F. Supp. 2d 741 (D. Md. 2008). Judge Motz echoed his earlier ruling denying motions to dismiss the Section 36(b) claims asserted against the Janus defendants and held, without substantial analysis, that "[t]o the extent that a portion of the fees paid to the investment adviser defendants was 'disproportionate, excessive, or unearned,' . . . because it was based upon the existence of market timing agreements or of insider market-timed trades not disclosed when the fees were negotiated, plaintiffs (derivatively, on behalf of the funds that paid the fees) may recover that portion of the fees." Id. at 759-60. It is worth noting that Judge Motz acknowledged the two different approaches to deciding the viability of Section 36(b) claims that have evolved—Gartenberg and Jones v. Harris—but found that the two approaches lead to the same place. Id.

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slip op. (D. Md. June 14, 2006); In re Mutual Funds Inv. Litig. (In re One Group Fund Derivative Sub-Track), No. 04-md-15863-05, slip op. (D. Md. June 14, 2006); In re Mutual Funds Inv. Litig. (In re Alger Fund Derivative Sub-Track), No. 04-md-15863, slip op. (D. Md. June 13, 2006); In re Mutual Funds Inv. Litig. (In re Alger Investor Class Sub-Track), No. 04-md-15863, slip op. (D. Md. June 13, 2006); In re Mutual Funds Inv. Litig. (One Group Investor Class Sub-Track), No. 04-md-15863-05, slip op. (D. Md. June 14, 2006); In re Mutual Funds Inv. Litig. (Putnam Investor Class Sub-Track), No. 04-md-15863, slip op. (D. Md. June 14, 2006).

On January 20, 2010, Judge Motz issued a decision in the Janus funds derivative litigation granting defendants' motion for summary judgment on plaintiffs' claim under Section 36(b)—the sole remaining claim in that action. See In re Mutual Funds Inv. Litig., 681 F. Supp. 2d 622 (D. Md. 2010). In doing so, Judge Motz held that the fiduciary duty under Section 36(b) has a scienter component. Id. at 628. According to the court:

> [A]llowing recovery in the absence of intentional or reckless adviser misconduct would be to concentrate on the compensation itself, not on the adviser's actions. This focusing on the compensation itself, and ignoring the advisers' conduct, would allow Section 36(b) to be used to *de facto* challenge the reasonableness of the fees, which is inconsistent with the text and intent of 36(b).

Id. As such, the court ruled, whether viewed under the "excessive/disproportionate" test of Gartenberg and its progeny, or the "honest negotiation" test of Jones v. Harris—the court held that it need not resolve which of the two standards is most appropriate because they both lead to the same place—Defendants could only be liable for the "'portion of the fees paid to the [Janus Defendants that] was disproportionate, excessive, or unearned . . . because it was based on the existence of market timing agreements or of insider market-timed trades not disclosed when the fees were negotiated . . . .'" Id. (quoting In re Mutual Funds Inv. Litig., 590 F. Supp. 2d 741, 760 (D. Md. 2008)).

Importantly, no other court has held that the fiduciary duty under Section 36(b) has a scienter requirement, a fact Judge Motz squarely acknowledges: "I suspect this is because proof of breach is usually powerful evidence of the adviser's state of mind." In re Mutual Funds Inv. Litig., 681 F. Supp. 2d at 629 n.12.

There have been a number of other decisions in connection with the mutual funds multidistrict litigation. For additional information, the reader is encouraged to visit the District of Maryland's Mutual Funds Investment Litigation website at http://www.mdd.uscourts.gov/mdl/mdl.asp.

3. Outsourcing Payments to Affiliated Entities / Securities Lending

a. In In re Smith Barney Transfer Agent Litig., No. 05 Civ. 7583, 2007 WL 2809600 (S.D.N.Y. Sept. 26, 2007), plaintiffs alleged that in 1999 defendants recommended that the funds retain the services of what is now known as Citicorp Trust Bank ("CTB"), an affiliate of the funds' investment adviser, to serve as the primary transfer agent for the funds. Although CTB was responsible for providing all of the Smith Barney-branded mutual funds' transfer agent services, CTB allegedly subcontracted the vast majority of the transfer agent work to First Data Investor Services Group ("First Data"). Pursuant to this subcontract, it was alleged that First Data charged significantly lower fees, yet CTB did not pass

on those discounts to the funds, nor did the funds' investment adviser disclose to the funds such discounts or that First Data performed most of the transfer agent services. Id. at *1. Based on these allegations, plaintiffs asserted claims under Sections 10(b) and 20(a) and Rule 10b-5 of the Securities Exchange Act of 1934 and Section 36(b) of the Act. Defendants moved to dismiss the complaint in its entirety, including plaintiffs' Section 36(b) claim, arguing, inter alia, that the claim was improperly asserted directly as a putative class action rather than derivatively on behalf of the subject funds. Id. at *4. The court agreed and dismissed plaintiffs' Section 36(b) claim. Id. Applying the law of the state of the funds' incorporation, the court held that the purported injury was suffered, if at all, directly by the funds, and that the claims were therefore derivative in nature. Id.

One of the plaintiffs appealed the decision. On appeal, the United States Court of Appeals agreed with the district court that an action under Section 36(b) is derivative, and rejected plaintiff's argument that it could assert claims under Section 36(b) in which the recovery would go to it directly. Operating Local 649 Annuity Trust Fund v. Smith Barney Fund Mgmt. LLC, 595 F.3d 86, 97 (2d Cir. 2010). "To the extent Local 649 seeks damages that inure to its own benefit and not to the Funds', that result is not permitted by § 36(b)." Id. at 98. The Second Circuit reversed the district court's dismissal of plaintiffs' securities fraud claim and remanded.

On remand, the defendants filed another motion to dismiss, which the district court granted in part and denied in part. See In re Smith Barney Transfer Agent Litig., 765 F. Supp. 2d 391 (S.D.N.Y. 2010). The court first discussed defendants' argument that plaintiffs lacked standing. With regard to the argument that plaintiffs should have brought their Section 10(b) claim derivatively—because plaintiffs only alleged harm to the funds—the court rejected defendants' argument: because plaintiffs claimed they were "fraudulently induced to purchase shares . . . they can be said to have suffered a direct injury." See In re Smith Barney, 765 F. Supp. 2d at 399.

Next, the court held that plaintiffs lacked standing to pursue claims on behalf of funds in which no named plaintiff invested, and dismissed claims "on behalf of mere holders of Smith Barney Funds securities," because "§ 10(b) limited private causes to action to purchasers and sellers." Id. at 399-400.

The court then rejected defendants' argument that plaintiffs' claims were time-barred. With regard to news articles cited by

defendants, the court noted that the articles' reference to investigators "trying to determine Defendants' culpability demonstrates that any evidence of Defendants' mental state had not yet been uncovered. Thus, because a reasonably diligent investor would not necessarily have discovered facts establishing that Defendants acted intentionally or with reckless disregard, Plaintiffs' claims are not time-barred." Id. at 400-01 (citations omitted).

Next, the court dismissed one of the individual defendants on the grounds that he did not make any of the false statements alleged in the complaint. While the court acknowledged the efficacy of the group pleading doctrine, which presumes that corporate disclosures are the collective work of, and can be attributed to, those with "direct involvement in the everyday business of the company," the court declined to apply the doctrine to the chief executive officer of Citigroup Asset Management. Id. at 401. The court found that since the complaint alleged no direct involvement by the individual in the adviser's recommendations to the funds' board, and because the individual was not an officer of the Smith Barney funds, that it would be inappropriate to apply the doctrine against him. Id.; see also id. at 402 (dismissing Section 20(a) claim against this individual).

Shockingly, lead plaintiffs' counsel subsequently informed the court that the lead plaintiff did not actually own shares in the at-issue fund (rather lead plaintiff owned shares in a similarly named fund). After excoriating the lawyers for both sides for letting this error go unnoticed for six years of litigation, the court dismissed lead plaintiff and set a briefing schedule for an appointment of a new lead plaintiff and lead counsel. See In re Smith Barney Transfer Agent Litig., No. 05 Civ. 7583, 2011 WL 4430857 (S.D.N.Y. Sept. 22, 2011).

After plaintiffs resolved the standing issue, plaintiffs re-filed their action, and defendants again moved to dismiss. The court ultimately dismissed the claims against the investment adviser and one of the individual defendants for failure to plead reliance, but sustained a Rule 10b-5(b) claim against another individual defendant who had signed allegedly misleading fund documents. See infra In re Smith Barney Fund Transfer Agent Litig., No. 05 Civ. 7583, 2012 WL 3339098 (S.D.N.Y. Aug. 15, 2012).

b. In Laborers' Local 265 Pension Fund v. iShares Trust, No. 3:13-cv-00046, 2013 WL 4604183 (M.D. Tenn. Aug. 28, 2013), plaintiffs, investors in certain iShares exchange traded funds, filed a derivative action on behalf of the funds, asserting claims under

Sections 36(a), 36(b) and 47(b) of the Act and seeking the return of allegedly "excessive" fees, contractual rescission and injunctive relief. Plaintiffs asserted the claims against the funds as nominal defendants, as well as BlackRock Fund Advisors ("BFA"), BlackRock Institutional Trust Company, N.A. ("BTC") and individual directors of the funds. BFA acted as investment adviser to the funds, while BTC was hired by BFA to act as securities lending agent to the funds. Plaintiffs sought to recover revenue derived from BTC's lending of the funds' securities, alleging that the 35 percent fee-split of this revenue, approved by the funds' directors, was excessive. Id. at *1-2.

Plaintiffs also alleged that an additional 5 percent of securities lending revenue was paid to BlackRock affiliates as administrative fees, resulting in a "40/60 division of revenue between the BlackRock affiliates and the iShares funds" that was likewise excessive, when compared to fees paid by "peer mutual funds, and, in particular, compared to funds which employ unaffiliated lending agents." Id. at *2.

In dismissing plaintiffs' Section 36(b) claim, the court relied primarily on an SEC Exemption Order issued pursuant to Sections 6(c) and 17(b) of the Act, which applied to the securities lending agreement at issue. The court explained that because Section 36(b)(4) of the Act provides that Section 36(b) is inapplicable to payments or compensation made in connection with orders under Section 17 of the Act, plaintiffs' Section 36(b) claim must be dismissed. Id. at *3, *5-6.

The court also dismissed plaintiffs' claims under Sections 36(a) and 47(b), finding that plaintiffs failed to overcome the presumption that no private right of action exists under those sections of the Act. Id. at *6-10.

Although the court's dismissal was without prejudice and provided plaintiffs with an opportunity to file a motion for leave to amend by September 17, 2013, the court specifically noted that if such a motion was not filed, "the court will enter final judgment in the case." Id. at *10. Plaintiffs subsequently sought an extension of time to file their motion by October 17, 2013, which was granted. After the extended deadline passed, on October 22, 2013, defendants moved to dismiss the case, which the court granted shortly thereafter. See Laborers' Local 265 Pension Fund v. iShares Trust, No. 3:13-cv-00046 (M.D. Tenn. Oct. 24, 2013).

Plaintiffs appealed the dismissal of their Section 36(a) and 36(b) claims only. See Laborers' Local 265 Pension Fund v. iShares

Trust, 769 F.3d 399 (6th Cir. 2014). On appeal, the United States Court of Appeals for the Sixth Circuit affirmed the district court's decision. Id. at 409.

In affirming the dismissal of plaintiffs' claim under Section 36(b), the Sixth Circuit agreed with the district court that the claim must fail because the SEC Exemption Order triggered the carve-out provision in Section 36(b)(4). Id. at 405.

Moreover, the Sixth Circuit rejected plaintiffs' argument that BTC's lending fee should be aggregated with BFA's separate advisory fee for the purpose of analyzing their claim under Section 36(b) for a number of reasons. Id. at 403-6. First, the court found that the argument was forfeited because the allegations in the complaint pertained only to BTC's lending fee. Id. at 404. Second, even if the complaint had contained specific allegations against BFA's advisory fee, the court noted that the Second Circuit, in Meyer v. Oppenheimer Management Corp., 895 F.2d 861 (2d Cir. 1990), had rejected a similar argument regarding the aggregation of separate fees. Id. at 404. The court adopted the rationale of Meyer and found that BFA's advisory fee was "altogether separate from the lending fee charged by BTC and thus provides no logical basis for aggregating the two." Id. at 404-5. Finally, the court explained that Section 36(b)(3) also undermined plaintiffs' argument because BFA was not a "recipient" of BTC's lending fee as required by the plain text of that provision. Id. at 405.

Turning to plaintiffs' claim under Section 36(a), the Sixth Circuit held that no private cause of action exists under that Section of the Act. Id. at 406-9. In so holding, the court concluded that neither the text nor structure of the Act indicates an intent by Congress to create an implied private right of action under Section 36(a). Id. at 408-9. To support this conclusion, the court explained that "[t]he creation of an express private right of action in Section 36(b) strongly implies the absence of such a right in Section 36(a)." Id. at 408. Furthermore, the court found the language of Section 36(a) lacks language that creates rights, and instead "focuses on the person regulated rather the individuals protected." Id. at 407 (internal quotation and citation omitted).

4. Other Attempts to Expand the Scope of Section 36(b)

Over the years, plaintiffs have tried in earnest to expand the scope of Section 36(b), by challenging:

a. Failure to participate in class actions—see Hamilton v. Allen, 396 F. Supp. 2d 545 (E.D. Pa. 2005); Stegall v. Ladner, 394 F. Supp. 2d 358 (D. Mass. 2005); Hogan v. Baker, No. Civ. A. 305CV73P, 2005 WL 1949476 (N.D. Tex. Aug. 12, 2005); Dull v. Arch, No. 05 C 140, 2005 WL 1799270 (N.D. Ill. July 27, 2005); Jacobs v. Bremner, 378 F. Supp. 2d 861 (N.D. Ill. 2005); Mutchka v. Harris, 373 F. Supp. 2d 1021 (C.D. Cal. 2005); Davis v. Bailey, No. CIVA05CV42, 2005 WL 3527286 (D. Colo. Dec. 22, 2005); Everett v. Bozic, No. Civ. 00296, 2006 WL 2291083 (S.D.N.Y. Aug. 3, 2006).

b. Portfolio selections—see Benak v. Alliance Capital Mgmt. L.P., No. Civ. A. 01-5734, 2004 WL 1459249 (D.N.J. Feb. 9, 2004).

c. Fund mergers—see Olesh v. Dreyfus Corp., No. CV-94-1664, 1995 WL 500491 (E.D.N.Y. Aug. 8, 1995); Wexler v. Equitable Capital Mgmt. Corp., No. 93 Civ. 3834, 1994 WL 48807 (S.D.N.Y. Feb. 17, 1994).

d. Rights offerings—see In re Nuveen Fund Litig., No. 94 C 360, 1996 WL 328006 (N.D. Ill. June 11, 1996); Strougo v. Scudder, Stevens & Clark, Inc., 964 F. Supp. 783 (S.D.N.Y. 1997); King v. Douglass, 973 F. Supp. 707 (S.D. Tex. 1996).

e. The use of leverage—see Green v. Fund Asset Mgmt., L.P., 19 F. Supp. 2d 227 (D.N.J. 1998); Green v. Fund Asset Mgmt., L.P., 53 F. Supp. 2d 723, 731 (D.N.J. 1999), rev'd, 245 F.3d 214 (3rd Cir. 2001) (Section 36(b) does not preempt state law claims for breach of fiduciary duty and deceit); Green v. Fund Asset Mgmt., L.P., 147 F. Supp. 2d 318 (D.N.J. 2001), aff'd, 286 F.3d 682 (3d Cir.), cert. denied, 537 U.S. 884 (2002); Green v. Nuveen Advisory Corp., 186 F.R.D. 486, 490 (N.D. Ill. 1999); Green v. Nuveen Advisory Corp., No. 97 C 5255, 2001 WL 1035652 (N.D. Ill. Sept. 10, 2001), aff'd, 295 F.3d 738 (7th Cir.), cert. denied, 537 U.S. 1088 (2002).

f. Annuity contracts—see Levy v. Alliance Capital Mgmt. L.P., No. 97 Civ. 4672, 1998 WL 744005 (S.D.N.Y. Oct. 26, 1998), aff'd, 189 F.3d 461 (2d Cir. 1999).

g. The propriety of directors serving on the boards of multiple funds[15]—see Migdal v. Rowe Price-Fleming, No. 98-2162, 1999

[15] For a discussion of the background which prompted these cases, see James N. Benedict & Mary K. Dulka, "Recent Developments in Litigation Under the Investment Company Act of 1940," Rev. of Sec. & Commodities Reg., Vol. 35, No. 14 (August 2002), at 156-57.

WL 104795 (D. Md. Jan. 20, 1999); Migdal v. Rowe Price-Fleming Int'l, No. 98-2162, 2000 WL 350400 (D. Md. Mar. 20, 2000), aff'd, 248 F.3d 321 (4th Cir. 2001); see also Verkouteren v. Blackrock Fin. Mgmt., Inc., 37 F. Supp. 2d 256 (S.D.N.Y. 1999); Verkouteren v. Blackrock Fin. Mgmt., Inc., No. 98 Civ. 4673, 1999 WL 511411 (S.D.N.Y. July 20, 1999), aff'd, 208 F.3d 204 (2d Cir. 2000) (unpublished table opinion); Krantz v. Prudential Invs. Fund Mgmt. LLC, 77 F. Supp. 2d 559 (D.N.J. 1999), aff'd, 305 F.3d 140 (3d Cir. 2002), cert. denied, 537 U.S. 1113 (2003); Strougo v. BEA Assocs., No. 98 Civ. 3725, 1999 WL 147737 (S.D.N.Y. Mar. 18, 1999); Strougo v. BEA Assocs., No. 98 Civ. 3725, 2000 WL 45714 (S.D.N.Y. Jan. 19, 2000); Strougo v. BEA Assocs., 188 F. Supp. 2d 373 (S.D.N.Y. 2002); Krantz v. Fidelity Mgmt. & Research Co., 98 F. Supp. 2d 150 (D. Mass. 2000); Miller v. Mitchell Hutchins Asset Mgmt., Inc., No. 01-CIV-192 (S.D. Ill. Mar. 12, 2002); Nelson v. AIM Advisors, Inc., No. 01-CV-282, 2002 WL 442189 (S.D. Ill. Mar. 8, 2002).

h. Failure to reduce a fund's trading discount—see, e.g., Marquit v. Dobson, Nos. 98 Civ. 9089, 98 Civ. 9059, 98 Civ. 9088, 2000 WL 4155 (S.D.N.Y.), aff'd sub nom. Marquit v. Williams, 229 F.3d 1135 (2d Cir. 2000) (unpublished decision).

i. Payment of membership dues to the ICI—see Rohrbaugh v. Investment Co. Inst., No. Civ. A. 00-1237, 2002 WL 31100821 (D.D.C. July 2, 2002).

j. Fees of underlying funds in "fund of funds"—see Curran v. Principal Mgmt. Corp., No. 4:09-cv-433, 2010 WL 2889752, at *6 (S.D. Iowa June 8, 2010) (concluding Section 36(b) "creates a private right of action for all 'security holders' in the registered investment company, including persons who possess an interest in a mutual fund that is acquired through a fund of funds"), vacated by 2011 WL 223872 (S.D. Iowa Jan. 24, 2011); Sivolella v. AXA Equitable Life Ins. Co., No. 11-4194, 2012 WL 4464040 (D.N.J. Sept. 25, 2012).

D. Preemption of State Law Claims

In a case of first impression in the federal courts, the U.S. District Court for the District of New Jersey, in Green v. Fund Asset Mgmt., L.P., 53 F. Supp. 2d 723 (D.N.J. 1999), dismissed plaintiffs' state law claims for breach of fiduciary duty and deceit on the ground that they were preempted by Section 36(b). The court noted that Congress enacted the Investment Company Act because it had concluded that the nationwide activities of investment companies called for federal regulation and that Section 36(b), in particular, was enacted to "cur[e] the ineffectiveness of the existing remedies by creating a new federal claim for breach of fiduciary duty that could only be brought in federal

courts." Id. at 730. The court further noted that "Section 36(b) limits the parties against whom relief may be sought, limits the type and amount of relief a shareholder may recover, imposes upon the plaintiff the burden of proving that the adviser breached its fiduciary duty, limits the plaintiff to the forum of federal court, creates no right of action for the fund itself and limits the plaintiff to a non-jury trial," and that "[e]ach of these limitations is at odds with plaintiffs' common law claims." Id. Thus, "allowing plaintiffs' inconsistent state law parallel actions would frustrate the statutory scheme purposefully put into place by Congress in Section 36(b)." Id. at 731.

On appeal, the Third Circuit reversed the district court decision and remanded for further proceedings. See Green v. Fund Asset Mgmt., L.P., 245 F.3d 214 (3d Cir. 2001). The Circuit Court found unavailing defendants' reliance on several district court and Supreme Court preemption cases and determined that, under the Supreme Court's "conflict preemption" jurisprudence, the plaintiffs' state law claims for breach of fiduciary duty and deceit did not "stand[] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." Id. at 230. The court was not persuaded by defendants' argument that various procedural differences between the Section 36(b) action and similar state law claims[16] indicated congressional intent to preempt the plaintiffs' state law claims and thus those state law claims would, as the district court noted, "frustrate the statutory scheme" created by Congress in Section 36(b). See Green, 53 F. Supp. 2d at 731. Instead, the Circuit Court found such procedural differences evidence of a congressional balancing between a "markedly more 'plaintiff-friendly'" Section 36(b) and the "'corporate waste' standard applied by most state courts prior to 1970." Green, 245 F.3d at 229. Defendants later successfully moved for summary judgment dismissing the case.[17]

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[16] Those "procedural" differences include: the parties against whom relief may be sought; the type and amount of relief recoverable; the scope of advisory fees recoverable; the party bearing the burden of proof; the court in which the action must be brought; the proper parties; and the right (or lack thereof) to jury trial. See id. at 226-27.

[17] While state law actions against the mutual fund industry remain viable, such actions may be subject to preemption under SLUSA. See, e.g., Brown v. Calamos, No. 11-1785, 2011 WL 5505375 (7th Cir. Nov. 10, 2011) (affirming dismissal of action on SLUSA grounds because "[t]hough the suit is for breach of fiduciary obligations, the breach appears to rest on an allegation of fraud, as is often the case.").

Investment advisers have also successfully defended state law fiduciary duty actions on the basis that such actions are derivative in nature (and thus are protected by the demand requirement). See Gomes v. Am. Century Cos., No. 10-83-CV, Order (W.D. Mo. Feb. 16, 2012); McVeigh v. Callan Assocs. Inc.,, No. 09-CV-685, 2012 WL 1155783 (N.D. Ala. Mar. 26, 2012); Averbuch v. Arch, No. 201102502, 2013 WL 5531396 (Mass. Super. Aug. 27, 2013); Halebian v. Berv, No. 12-3360, 2013 WL 5977962 (2d Cir. Nov. 12, 2013).

IV. IMPLIED RIGHTS OF ACTION: THE NOUVEAU REGIME

Previously, some courts demonstrated a willingness to find implied private rights of action for breach of fiduciary duty claims under Section 36(a) of the Act, despite a complete lack of contemporaneous legislative history supporting the existence of such an implied right. Under those cases, plaintiffs could plead "federalized" breach of fiduciary duty claims under Section 36(a) that may survive a motion to dismiss, and essentially litigate under Section 36(a) or other sections of the Act claims not encompassed by the express right of action set forth in Section 36(b).[18] However, in a case of first impression, one federal Court of Appeals in 2002 held that no private right of action exists under Section 26(e) and 27(i) of the Act, which prohibit unreasonable charges on variable insurance contracts. Since then, courts have continued to decline overtures to imply rights of action under the Act.

A. Finding Implied Rights Under the Act

1. Legislative History of the Act

When originally enacted, the Act did *not* expressly provide private citizens with any enforcement rights under *any* provision of the Act. The 1940 Congress did not provide for implied rights because: (1) claims under the Act could usually be brought as registration or disclosure claims under the Securities Act of 1933 and/or the Securities Exchange Act of 1934, where private enforcement remedies already existed; and (2) the Act was passed as a comprehensive *federal regulatory scheme* to protect shareholders from self-dealing and other abuses. 15 U.S.C. § 80a-1 (1997) (Findings and Declarations of Policy).

Responding to the specific problem of exploding investment advisory fees, Congress *expressly* provided private citizens ("security holders") with a limited cause of action under the 1970 Amendments to the Act at Section 36(b).

Also, as part of the 1970 Amendments, Congress enacted Section 36(a) (discussed infra Section IV.B), which provides in relevant part that "*the Commission is*

In a recent decision, however, the Ninth Circuit held that allegations that trustees and an investment adviser breached fiduciary duties to shareholders by failing to manage a fund in accordance with its fundamental investment objectives could be brought directly. Northstar Fin. Advisors, Inc. v. Schwab Invs., 779 F.3d 1036 (9th Cir. 2015). The court held that a direct action is appropriate where a claim implicates a shareholder's contractual rights, and plaintiff's claim implicated both shareholders' right to vote, and right to have the fund managed in accordance with its investment objectives. Id. at 1057-58. The court asserted that "the distinction between direct and derivative actions has little meaning in the context of mutual funds" because unlike corporations, mutual funds are focused only on investing assets to increase their value for the benefit of shareholders, and thus "the impact [of a breach] is directly on the investors in the Fund and a recovery would not be dependent on demonstrating an injury to the Schwab Trust." Id. at 1058.

[18] For a more comprehensive discussion of implied rights of action under the 1940 Act, see Benedict, Kornfeld, & Swift, "Implied Rights of Action Under the Investment Company Act of 1940," Rev. of Sec. & Commodities Reg., Vol. 30, No. 19, Nov. 5, 1997.

authorized to bring an action alleging that a person has engaged within five years of the commencement of the action or is about to engage in any act or practice constituting a breach of fiduciary duty involving personal misconduct in respect of any registered investment company." 15 U.S.C. § 80a-35(a) (emphasis added).

On its face, Section 36(a) was limited to SEC actions. This counsels against implying private rights of action under the section. Likewise, the fact that Section 36(a) contains a five-year limitations period for claims brought by the Commission, whereas Section 36(b) provides private citizens a one-year limitations period to sue in limited circumstances, further suggests that private rights of action should not be so readily implied across the Act. Finally, a logical reading of the two provisions—albeit not one that has been adopted by the courts—is that only Section 36(b) was intended to provide for a private cause of action. Otherwise it would be rendered a nullity and unnecessary, since Section 36(a) arguably would encompass all private claims brought under Section 36(b) (i.e., a breach of fiduciary duty involving personal misconduct claim would pick up claims of "excessive compensation" under Section 36(b)). The Senate and House Reports accompanying the 1970 Amendments, however, have noted that the fact that Section 36(b) specifically provides for a private right of action "should not be read to affect Section 36(a)." S. Rep. No. 91-184 (1969), reprinted in 1970 U.S.C.C.A.N. 4897; H. Rep. No. 91-1382, 91st Cong. 2d Sess. 38 (1970).

In 1980, the Act was amended again in connection with Sections 17, 56, and 57. The 1980 House Report—written some forty years after the original passing of the Act—expresses the expectation that courts will imply private rights of action under the Act where the plaintiff falls into the class of people protected by the statutory provision in question. Pub. L. No. 96-477 (although the Committee fails to specify any particular statutory section other than Section 36(a), it stated that the "Committee wishes to make plain that it expects the courts to imply private rights of action under this legislation. . . .")

2. Implied Rights of Action: The Act and Central Bank

The U.S. Supreme Court has never expressly recognized an implied right of action under the Act, expressly declining the opportunity to do so. Kamen v. Kemper Fin. Servs., Inc., 500 U.S. 90, 97 n.4 (1991); Daily Income Fund, Inc. v. Fox, 464 U.S. 523, 536-41 (1984). Nevertheless, despite the lack of any such precedent, and the lack of any contemporaneous legislative history favoring implied rights, district and circuit courts alike implied rights of action under the Act for private citizens for decades. For example, in Fogel v. Chestnutt, 668 F.2d 100, 112 (2d Cir. 1981), cert. denied, 459 U.S. 828 (1982), the court opined that "[i]n adopting a statute intended as a thorough and pervasive regulation of the investment company industry . . . it seems to us highly unlikely that Congress intended that . . . enforcement should be solely the task of the SEC and of the criminal law, and that injured investors should have no recourse in a federal court."

The Supreme Court, however, signaled a strong presumption against implying private rights of action under the federal securities laws. See Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164 (1994). In Central Bank the Supreme Court held that there was no implied private right of action for aiding and abetting a violation of section 10(b) under the 1934 Act. The decision and its rationale is marked by the following:

(1) The opinion overruled decisions by all eleven federal courts of appeal and dozens of district courts in the nation which had been implying private rights of action for aiding and abetting Section 10(b) claims for decades. The decision strongly suggests that the mere fact that other courts have implied private rights is not a sufficient basis to continue to do so.

(2) The original issue presented for review was whether recklessness satisfied the scienter requirement for aiding and abetting a violation of Section 10(b) of the 1934 Act; however, the Court sua sponte directed the parties to first brief and then argue the issue of whether an implied right of action for aiding and abetting violations even existed. By this extraordinary step, the Court seemed to telegraph its view that implying private rights of action should only be done in the rarest of circumstances, noting that Congress knew how to impose express remedies "when it chose to do so." Id. at 176.

(3) Although a Securities Exchange Act of 1934 case from the perspective of statutory interpretation, the broad language of Central Bank should limit a plaintiff's ability to bring implied rights of action under the securities laws generally and, in particular, under the Act. Central Bank plainly instructs that absent express statutory language providing citizens a private right of action, federal courts should decline to imply one, since "[i]t is inconsistent with settled methodology . . . to extend liability beyond the scope of conduct prohibited by the statutory text." Id. at 177.

(4) Likewise, the Court noted that it was only the legislative history *contemporaneous* with the passing of the statute—and not any subsequent legislative history—which is dispositive. The Court noted that as it has "observed on more than one occasion . . . the interpretation given by one Congress (or a committee or Member thereof) to an earlier statute is of little assistance in discerning the meaning of that statute." Id. at 173-74, 185-86 n.4.

(5) The Court also explicitly criticized and rejected the "acquiescence" doctrine favoring implied rights articulated in Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353, 378-79 (1982), which had been the basis for finding many implied rights of action under the Act for over a decade. In this respect, the Court noted that:

> our observations on the acquiescence doctrine indicate its limitations as an expression of congressional intent. It does not follow . . . that Congress' failure to overturn a statutory precedent is reason for this Court to adhere to it. It is impossible to assert with any degree of assurance that congressional failure to act represents affirmative congressional approval of the [courts'] statutory interpretation. . . . Congressional inaction cannot amend a duly enacted statute.

Central Bank, 511 U.S. at 186 (citations omitted).

3. Olmsted and Other Cases Since Central Bank

a. Supreme Court

(1) In Alexander v. Sandoval, 532 U.S. 275 (2001), the United States Supreme Court found that no private right of action exists under disparate-impact regulations promulgated under Section 602 of Title VI of the Civil Rights Act of 1964, even though implied private rights do exist under Section 601 of Title VI. While not a case involving the Act or any other federal securities law, Sandoval is significant because it has been cited repeatedly in subsequent decisions under the Act.

In Sandoval, the Supreme Court began by stating that "[l]ike substantive federal law itself, private rights of action to enforce federal law must be created by Congress," and that "[t]he judicial task is to interpret the statute Congress has passed to determine whether it displays an intent to create not just a private right but also a private remedy." Sandoval, 532 U.S. at 286 (citation omitted). The Supreme Court noted that "[s]tatutory intent on this latter point is determinative," because "[w]ithout it, a cause of action does not exist and courts may not create one, no matter how desirable that might be as a policy matter, or how compatible with the statute." Id. at 286-87 (citations omitted). It rejected the plaintiff's attempt to "revert in this case to the understanding of private causes of action that held sway 40 years ago when Title VI was enacted," referring to that time period as the "*ancien regime*." Id. at 287. The Supreme Court compared the "rights-creating language" in Section 601 ("[n]o person . . . shall . . . be subjected to discrimination") with the language of Section 602, which limited federal departments and agencies to "effectuating" rights already created under Section 601, and

found that Section 602 revealed no congressional intent to create a private right of action. Id. at 289.

(2) The Supreme Court offered additional guidance on statutory interpretation which further impacted how courts view implied rights under the Act. In Exxon Mobil Corp. v. Allapattah Servs., Inc., 545 U.S. 546 (2005), the Supreme Court held that "the authoritative statement is the statutory text, not the legislative history or any other extrinsic material." Id. at 568. In Exxon Mobil, the Court was asked to determine whether a federal court in a diversity action may exercise supplemental jurisdiction over additional plaintiffs whose claims do not satisfy the minimum amount-in-controversy requirement, provided the claims are part of the same case or controversy as the claims of plaintiffs who do allege a sufficient amount in controversy. The question turned on the correct interpretation of 28 U.S.C. § 1367. The Court found that there was no reason to look beyond the text of Section 1367 to the legislative history because the text of Section 1367 is not ambiguous and to foreclose the exercise of supplemental jurisdiction over plaintiffs in diversity cases who do not meet the minimum amount in controversy would be inconsistent with that text. Exxon Mobil, 545 U.S. at 566-67. Moreover, the court held that "legislative history in particular is vulnerable to two serious criticisms. First, legislative history is itself often murky, ambiguous, and contradictory. . . . Second, judicial reliance on legislative materials like committee reports, which are not themselves subject to the requirements of Article I, may give unrepresentative committee members—or, worse yet, unelected staffers and lobbyists—both the power and the incentive to attempt strategic manipulations of legislative history to secure results they were unable to achieve through the statutory text." Id. at 568. Exxon Mobil has already been cited in at several decisions finding that there is no implied private rights of action under various sections of the Act.

b. Circuit Courts

(1) In a case of first impression, the Second Circuit affirmed the district court's decision holding that there is no private right of action for violations of Sections 26(f) or 27(i) of the Act. Olmsted v. Pruco Life Ins. Co. of N.J., 283 F.3d 429 (2d Cir. 2002), aff'g 134 F. Supp. 2d 508 (E.D.N.Y. 2000). This is the first time a United States Court of

Appeals has refused to find an implied private right of action under the Act.

Plaintiffs in Olmsted invested in variable annuity contracts issued by defendant Pruco Life, a subsidiary of defendant Prudential Life Insurance Company of America, that combined both insurance and investment features. The investment feature permitted contract holders to allocate a portion of their purchase payments to separate accounts which invest in shares of specified mutual funds. Defendants provide a variety of insurance protections under the contracts, such as a guaranteed death benefit, for which it assumes certain risks and charges certain fees. Those fees are in addition to any fees charged by the investment advisors that manage the investments for the customer's separate accounts.

Plaintiffs alleged that virtually all of the fees collected represented profit to the defendants and thus were excessive and unreasonable in light of the benefits provided, in violation of Sections 26(e) and 27(i) of the Act. Those sections prohibit the sale of variable insurance contracts unless the fees and charges deducted under the contract, in the aggregate, are "reasonable in relation to the services rendered, the expenses expected to be incurred, and the risks assumed by the insurance company." 15 U.S.C. § 80a-26(e)(2)(A).

In deciding the case, although the district court did not specifically rely on Central Bank, it found that there is no private right of action under those sections. The district court *did* rely on the four-factor analysis set forth by the United States Supreme Court in Cort v. Ash, 422 U.S. 66 (1975),[19] but focused primarily on "the paramount importance of legislative intent". Olmsted, 134 F. Supp. 2d at 512.

The district court began with the language of the statute itself (see, e.g., Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 16 (1979)) and found that the phrase "'it shall be unlawful' merely prohibits certain conduct; it

[19] Those factors are: (1) whether the plaintiff is one of the class for whose benefit the statute was enacted; (2) whether there is any indication of legislative intent, explicit or implicit, to create or deny such a remedy; (3) whether the private right of action would be consistent with or frustrate the purposes of the legislative scheme; and (4) whether the cause of action is traditionally relegated to state law remedies. See Cort, 422 U.S. at 78.

does not in its terms create or alter any civil remedies." Id. Further, the court noted that the SEC had specifically been provided with the broad regulatory powers to enforce compliance with the provisions of the Act. "In view of [the Act's] comprehensive enforcement provisions expressly designating the SEC as the regulatory entity, it is highly improbable that 'Congress absentmindedly forgot to mention an intended private action' as a supplemental enforcement mechanism." Id. at 513 (quoting Cannon v. University of Chicago, 441 U.S. 677, 742 (1979)).

The court also found it significant that Congress had specifically created a private right of action under Section 36(b) when it amended the Act in 1970, evidence that Congress "knew how to do so" when it wanted to," but had not added similar language to Sections 26 and 27 when it amended those sections in 1996 to add the subsections at issue. Id. Further, said the court, the legislative history of the 1996 amendments "are wholly devoid of language creating a private cause of action for violation of its amended [Act] sections." Id. The court found that "[p]ermitting private parties to sue under the amended sections would contravene Congress' goal of achieving simple and flexible regulations." Id. at 513-14.

The court dismissed plaintiffs' arguments based on the first Cort factor that they are members of a class of persons whom Congress sought to protect. Because the issue of congressional intent has already been resolved, said the court, that factor "has little interpretive value." Id. at 514. The court further questioned the extent to which a private remedy would actually benefit the plaintiffs, finding "sporadic regulation through private rights of action in federal court" would probably "complicate and burden those provisions designed to protect the investors." Id. at 515.

The court found equally unavailing plaintiffs' argument that the legislative history of the 1980 amendments to the Act is evidence of Congress' intent that the courts infer private rights of action under the Act. The court noted that neither section at issue was amended (or even referenced) in the 1980 amendments. The court relied on Central Bank to indicate its unwillingness to "impute to the whole Congress in 1996 what was stated in a [committee] report in 1980." Id. (citing Central Bank, 511 U.S. at 185 ("[T]he interpretation given by one Congress (or a committee or

Member thereof) to an earlier statute is of little assistance in discerning the meaning of that statute.")).

Finally, plaintiffs argued that other courts had found implied private rights of action under other sections of the Act. The court cited the abundance of case law finding such implied rights under those other sections and noted that only one court had "ever even commented on the possibility of a private right of action under §§ 80a-26 and 80a-27." Id. at 516 (citing Barrett v. Van Kampen Merritt, Inc., No. 93 C 366, 1993 WL 95382 (N.D. Ill. Mar. 30, 1993). "The mere fact that courts have interpreted other [Act] sections to imply private rights of action does not compel the conclusion that Congress intended §§ 80a-26(e) and 80a-27(i) to be interpreted the same way." Id.[20]

Plaintiffs appealed that decision to the United States Court of Appeals for the Second Circuit. After the parties briefed and argued the appeal, the Second Circuit asked the SEC for its views. The SEC's amicus brief took no position on whether there was an implied private right of action under Sections 26 and 27, but argued that the court need not decide that issue because plaintiffs had an "express" remedy under Section 47(b) of the Act, which permits rescission of a contract which violates the Act.

The Second Circuit then affirmed the district court's opinion. See 283 F.3d 429 (2d Cir. 2002). It explained that congressional intent is "determinative" of whether a federal private right of action exists for violations of a federal statute. The Second Circuit found three compelling indicia that Congress did *not* intend to create a private right of action under Sections 26(f) and 27(i): (1) the sections do not contain "rights-creating language;" (2) Section 42 of the Act already provides for enforcement of all Act

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[20] Cf. Green, 19 F. Supp. 2d 227 (assuming without deciding that implied rights exist, but noting that there is no need for implied rights under §§ 8(a), 34(b) or 36(a) when plaintiffs' grievances fall within the private right of action provided for by § 36(b) since § 36(b) is the "exclusive" remedy).

Other district courts have applied Central Bank to preclude aiding and abetting, and other secondary liability causes of action under provisions of the federal securities laws other than Rule 10b-5 of the 1934 Act. See, e.g., Dep't of Econ. Dev. v. Arthur Andersen & Co., 924 F. Supp. 449, 475-77 (S.D.N.Y. 1996) (no aiding and abetting under RICO); In re Faleck & Margolies, Ltd., No. 89 B11140, 1995 WL 33631, at *12 (S.D.N.Y. Jan. 30, 1995) (no cause of action for conspiracy under the 1934 Act); SEC v. Militano, No. 89 Civ. 572, 1994 WL 558040, at *1 (S.D.N.Y. Oct. 11, 1994) (SEC determines that Central Bank would apply to SEC enforcement action, and that there is no aiding and abetting).

provisions by the SEC, but not by private litigants; and (3) Congress' provision of an express right of action under Section 36(b) of the Act suggests the intentional omission of a private right to enforce other sections. Id. at 432-33. The Second Circuit rejected plaintiffs' argument that a private right of action is supported by the legislative history of the Act, as well as the novel contention that a private right is necessary because Congress did not allocate the SEC enough money to enforce the Act by itself. Id. at 434-46.

As the Second Circuit recognized, the decision represents a significant break from the long-standing practice of an "overwhelming majority of courts" to find implied private rights of action under the Act. Nevertheless, the Court found this break compelled by a series of recent Supreme Court decisions declaring the practice of implying private rights of action an "*ancien regime*" (quoting Alexander v. Sandoval, 532 U.S. 275 (2001)). Id. at 434.

(2) In Bellikoff v. Eaton Vance Corp., 481 F.3d 110 (2d Cir. 2007), the Second Circuit reaffirmed its holding in Olmsted, finding that no private rights of action exist under Sections 34(b), 36(a), or 48(a) of the Act, and affirming the District Court's dismissal of plaintiffs' claims under those sections.

Plaintiffs brought suit alleging Eaton Vance and various affiliates had engaged in certain unlawful distribution practices. See In re Eaton Vance Mutual Funds Fee Litig., 380 F. Supp. 2d 222, 226-27 (S.D.N.Y. 2005). Defendants argued that no private right of action exists under Sections 34(b), 36(a), and 48(a) of the Act. The court agreed. Relying on Olmsted and the factors set out therein to assist in determining whether a private right of action exists, the court found that Congress did not intend to create a private right of action under those sections of the Act. In re Eaton Vance, 380 F. Supp. 2d at 231-34. First, "[n]one of these sections explicitly provides for a private right of action." Id. at 231 (footnote omitted). Further, "the sections do not contain 'rights-creating language' - rather, they describe prohibited actions and, in the case of § 36(a), specifically authorize the SEC to take action to enforce the provision." Id. at 231. The court also found it compelling that Congress provided an alternate method of enforcement through Section 42 of the Act and, indeed, had expressly provided a *private* right of action in Section 36(b) of the

Act. Id. Moreover, no court in the Second Circuit since Olmsted had found that Congress intended to create a private right of action under Section 34(b), 36(a), or 48(a), and, indeed, that "two well-reasoned decisions from district courts in this Circuit, citing Olmsted, have rejected the argument that Congress intended to create a private right of action under §§ 34(b) or 36(a)." In re Eaton Vance, 380 F. Supp. 2d at 232 (citing Chamberlain v. Aberdeen Asset Mgmt. Ltd., No. 02 Civ. 5870, 2005 WL 195520, at *2-3 (E.D.N.Y. Jan. 21, 2005) and In re Merrill Lynch & Co., Inc. Research Reports Sec. Litig., 272 F. Supp. 2d 243, 255-59 (S.D.N.Y. 2003)). "The reasoning of Olmsted dictates that there is no private right of action under §§ 34(b), 36(a), and 48(a)." In re Eaton Vance, 380 F. Supp. 2d at 233. See also In re Davis Selected Mutual Funds Litig., No. 04 Civ. 4186, 2005 WL 2509732, at *2 (S.D.N.Y. Oct. 11, 2005) (adopting Judge Koeltl's reasoning in the Eaton Vance decision and holding in a case containing "substantially the same allegations" that there is no private right of action under Section 34(b), 36(a), and 48(a) of the ICA).

On plaintiffs' motion for reconsideration, the court confirmed its holding that there is no private right of action under Sections 34(b), 36(a), and 48(a) of the Act. Judge Koeltl specifically held that Jackson v. Birmingham Bd. of Educ., 125 S. Ct. 1497 (2005),[21] is inapplicable to the analysis. See In re Eaton Vance Mutual Funds Fee Litig., 403 F. Supp. 2d 310, 313 (S.D.N.Y. 2005).

On appeal, the United States Court of Appeals for the Second Circuit affirmed Judge Koeltl's decision, holding that "implied private rights of action do not exist under [Sections] 34(b), 36(a), and 48(a)." Bellikoff, 481 F.3d at 117. Citing the Supreme Court's decision in Alexander v. Sandoval, 532 U.S. 275, 286 (2001), the Second Circuit first noted that any analysis begins and ends with Congressional intent, holding that "Congressional intent is the keystone as to whether a federal private right of action exists for a federal statute." Bellikoff, 481 F.3d at 116. Finding that no provision of the Act explicitly provides for

[21] Plaintiffs in Eaton Vance argued that Jackson and the legislative history of Section 36(a) supports a finding that Sections 34(b), 36(a), and 48(a) have implied rights of action. Plaintiffs in other cases have also spent significant time arguing that Jackson supports their arguments for private rights of action.

a private right of action for purported violations of Sections 34(b), 36(a), and 48(a), the Second Circuit began its analysis with the presumption that Congress did not intend such private rights of action—a presumption bolstered by three additional aspects of the Act: (1) Section 42 explicitly provides for enforcement of all provisions of the Act by the SEC, not by private litigants; (2) Section 36(b) explicitly provides a private litigant with a right of action, evidencing that "Congress's omission of an explicit private right of action in [Sections] 34(b), 36(a), and 48(a) was intentional" Id.; and (3) the absence of so-called "rights-creating language" indicates a lack of Congressional intent to create private rights of action. Id. Finding plaintiffs' reliance on outdated authority and post-enactment legislative history inapposite, the Court concluded that Sections 34(b), 36(a), and 48(a) do not provide for implied private rights of action and affirmed the lower court's ruling. Id. at 117.

(3) In Santomenno v. John Hancock Life Insurance Co., 677 F.3d 178 (3d Cir. 2012), the Third Circuit held that no private right of action exists under Section 47(b) of the Act to enforce Section 26(f) of the Act. The court held that "neither the language nor the structure of the ICA supports Participants' effort to insinuate their excessive fee claim into Section 47(b). Such a claim is cognizable under Section 36(b), but Participants lack standing to sue under that provision. They cannot circumvent their standing deficiency by resort to Section 47(b). Accordingly, Participants' Section 47(b) was properly dismissed." Id. at 187.

(4) In Laborers' Local 265 Pension Fund v. iShares Trust, 769 F.3d 399 (6th Cir. 2014), the Sixth Circuit held that no private cause of action exists under Section 36(a) of the Act. Id. at 406-9. In so holding, the court concluded that neither the text nor structure of the Act indicates an intent by Congress to create an implied private right of action under Section 36(a). Id. at 408-9. To support this conclusion, the court explained that "[t]he creation of an express private right of action in Section 36(b) strongly implies the absence of such a right in Section 36(a)." Id. at 408. Furthermore, the court found the language of Section 36(a) lacks language that creates rights, and instead "focuses on the persons regulated rather the individuals protected." Id. at 407 (internal quotation and citation omitted).

c. District Court Decisions – No Implied Private Right of Action

Since Olmsted, almost every single court that has directly addressed the issue has found that no implied private right of action exists under various sections of the Act. See, e.g., Laborers' Local 265 Pension Fund v. iShares Trust, No. 3:13-cv-00046, 2013 WL 4604183 (M.D. Tenn. Aug. 28, 2013) (Sections 47(b) and 36(a)); In re Oppenheimer Rochester Funds Group Secs. Litig., 838 F. Supp. 2d 1148 (D. Colo. 2012) (Section 13(a)); Smith v. Oppenheimer Funds Distrib., Inc., Nos. 10 Civ. 7387, 10 Civ. 7394, 2011 U.S. Dist. LEXIS 60877, at *24, 27 (S.D.N.Y. June 6, 2011) (Sections 47(b) and 36(a)); Wiener v. Eaton Vance Distribs., Inc., No. 10-10515, 2011 WL 1233131, at *11-13 (D. Mass. Mar. 30, 2011) (Sections 47(b) and 36(a)); In re Regions Morgan Keegan Sec., Derivative & ERISA Litig., 743 F. Supp. 2d 744, 761-62 (W.D. Tenn. 2010) (Sections 13, 22, 30, and 34(b)); Gabelli Global Multimedia Trust v. Western Inv. LLC, 700 F. Supp. 2d 748 (D. Md. 2010) (Section 12(d)(1)(A)(i) and 48(a)); Korland v. Capital Research and Mgmt. Co., et al., No. CV-08-4020, 2009 WL 936612 (C.D. Cal. Feb. 10, 2009) (Section 48(a)); Alexander v. Allianz Dresdner Asset Mgmt. of Amer. Holding, Inc., et al., 509 F. Supp. 2d 190 (D. Conn. 2007) (Sections 34(b), 36(a), and 48(a)); In re Scudder Mutual Funds Fee Litig., No. 04 Civ. 1921, 2007 WL 2325862 (S.D.N.Y. Aug. 14, 2007) (Section 48(a)); Halebian v. Berv, et al., 631 F. Supp. 2d 284 (S.D.N.Y. 2007) (Section 20(a)); Boyce v. AIM Mgmt. Group, Inc., et al., No. H-04-2587, 2006 WL 4671324 (S.D. Tex. Sept. 29, 2006) (Sections 34(b), 36(a), and 48(a)); Gilliam v. Fidelity Mgmt. & Research Co., et al., No 04-11600, slip op. (D. Mass. Sept. 18, 2006) (Sections 34(b), 36(a), and 48(a)); Siemers v. Wells Fargo & Co., No. C 05-4518, 2006 WL 2355411 (N.D. Cal. Aug. 14, 2006) (Section 48(a)); In re Salomon Smith Barney Mutual Fund Fees Litig., 441 F. Supp. 2d 579 (S.D.N.Y. 2006) (Sections 34(b) and 48(a)); In re Merrill Lynch Inv. Mgmt. Funds Sec. Litig., 434 F. Supp. 2d 233 (S.D.N.Y. 2006) (Sections 34(b), 36(a), and 48(a)); In re Morgan Stanley and Van Kampen Mutual Funds Sec. Litig., No. 03 Civ. 8208, 2006 WL 1008138 (S.D.N.Y. Apr. 18, 2006) (Sections 34(b) and 48(a)); In re BlackRock Mutual Funds Fee Litig., No. 04 Civ. 164, 2006 WL 4683167 (W.D. Pa. Mar. 29, 2006) (Sections 34(b), 36(a), and 48(a)); In re Evergreen Mutual Funds Fee Litig., 423 F. Supp. 2d 249 (S.D.N.Y. 2006) (Sections 34(b) or 36(a)); In re Oppenheimer Funds Fee Litig., 419 F. Supp. 2d 593 (S.D.N.Y. 2006) (Sections 34(b), 36(a) or 48(a)); Forsythe v. Sun Life Fin. Inc., 417 F. Supp. 2d 100 (D. Mass. 2006) (Sections 34(b), 36(a), and 48(a)); In re Goldman Sachs Mutual Funds Fee Litig., No. 04 Civ. 2567, 2006 WL 126772 (S.D.N.Y. Jan. 16, 2006) (Sections 34(b) and 36(a)); Davis v. Bailey, No. 05CV42, 2005 WL 3527286 (D. Colo. Dec. 22, 2005) (Section 36(a)); Waldock v. M.J. Select Global, Ltd., No. 03 C 5293, 2005 WL 3542527 (N.D. Ill. Dec. 27, 2005) (Section 48(a)); In re Am. Funds Mutual Funds Fee Litig., No. CV 04-5593, 2005 WL 3989803 (C.D. Cal. Dec. 16, 2005) (Section 34(b) and 36(a)); Yameen v. Eaton Vance

Distribs., Inc., 394 F. Supp. 2d 350 (D. Mass. 2005) (Section 36(a)); In re Dreyfus Mutual Funds Fee Litig., 428 F. Supp. 2d 342 (W.D. Pa. 2005) (Sections 34(b) and 36(a)); Stegall v. Ladner, 394 F. Supp. 2d 358 (D. Mass. 2005) (Section 36(a)); Hamilton v. Allen, 396 F. Supp. 2d 545 (E.D. Pa. 2005) (Section 36(a)); In re Franklin Mutual Funds Fee Litig., 388 F. Supp. 2d 451 (D.N.J. 2005) (Sections 34(b) and 36(a)); In re Lord Abbett Mutual Funds Fee Litig., 385 F. Supp. 2d 471 (D.N.J. 2005) (Sections 34(b) and 36(a)); In re Mutual Funds Inv. Litig. (In re Janus Subtrack Investor Class Op.), 384 F. Supp. 2d 845 (D. Md. 2005) (Section 34(b) and 36(a)); Dull v. Arch, No. 05 C 140, 2005 WL 1799270 (N.D. Ill. July 27, 2005) (Section 36(a)); Jacobs v. Bremner, 378 F. Supp. 2d 861 (N.D. Ill. 2005) (Section 36(a)); Mutchka v. Harris, 373 F. Supp. 2d 1021 (C.D. Cal. 2005) (Section 36(a)); DH2, Inc. v. Athanassiades, 359 F. Supp. 2d 708 (N.D. Ill. 2005) (Section 17(j)); Chamberlain v. Aberdeen Asset Mgmt. Ltd., No. 02-CV-5870, 2005 WL 195520 (E.D.N.Y. Jan. 21, 2005), vacated solely for purposes of settlement, 2005 WL 1378757 (E.D.N.Y. Apr. 12, 2005) (Section 36(a)); In re Van Wagoner Funds, Inc., 382 F. Supp. 2d 1173 (N.D. Cal. 2004) (Section 34(b)); In re Merrill Lynch & Co., Inc. Research Reports Sec. Litig., 272 F. Supp. 2d 243 (S.D.N.Y. 2003) (Section 34(b)); meVC Draper Fisher Jurvetson Fund I, Inc. v. Millennium Partners, L.P., 260 F. Supp. 2d 616 (S.D.N.Y. 2003) (Section 12(d)(1)); White v. Heartland High-Yield Municipal Bond Fund, 237 F. Supp. 2d 982 (E.D. Wis. 2002) (Sections 22 and 34(b)); Dorchester Investors v. Peak Int'l Ltd., 134 F. Supp. 2d 569 (S.D.N.Y. 2001) (Section 34(b)).

Although one federal district court in California broke rank, finding that Section 13(a) of the Act conferred an implied private right of action, see Northstar Financial Advisers, Inc. v. Schwab Investments, 609 F. Supp. 2d 938 (N.D. Ca. 2009), the Ninth Circuit, on an interlocutory appeal, reversed that court's judgment holding that "[n]either the language of § 13(a), the structure of the ICA, nor the statute's legislative history, including the addition of § 13(c), the Sudanese amendment, in 2007, reflect any congressional intent to create, or recognize a previously established, private right of action to enforce § 13(a). The job of enforcement remains exclusively with the SEC." Northstar Fin. Advisors, Inc. v. Schwab Invs., 615 F.3d 1106, 1122 (9th Cir. 2010).

Likewise, on April 6, 2010, the Southern District of New York, examining the same issue, concluded that because "Section 13(a) is not mentioned in 13(c)" and "Section 13(c) speaks of 'civil, criminal, or administrative action[s]' against investment companies and their advisers which might be brought under 'any' provision of Federal or State law," "the addition of Section 13(c) does not evince an intent on the part of Congress to *create* a private right of action under Section 13(a)." Western Inv. LLC v. DWS Global Commodities Stock Fund, Inc., 705 F. Supp. 2d 281, 285 (S.D.N.Y. 2010); see also In re Oppenheimer Rochester Funds Group

Secs. Litig., 838 F. Supp. 2d 1148, 1158-59 (D. Colo. 2012) (finding no private right of action under Section 13(a)).

d. Challenges to Alleged ICA Violations Under State Law

Although courts have consistently refused to recognize private rights of action to enforce many of the provisions of the ICA, a few notable recent opinions have given effect to efforts by plaintiffs to challenge alleged violations of Section 13(a) of the Act under state law causes of action.

(1) In Smit v. Charles Schwab & Co., No. 10-CV-3971, 2011 WL 846697 (N.D. Cal. Mar. 8, 2011), the court denied a motion to dismiss a complaint asserting a claim under the California Unfair Competition Law (UCL) based on an alleged violation of Section 13(a). "Although defendants correctly point out that the Ninth Circuit found that enforcement of the ICA was 'exclusively' granted to the SEC, this finding was not based on any express language in the ICA itself or in its legislative history. Without an express bar prohibiting private enforcement of the ICA § 13(a), the Court concludes that a UCL claim can proceed on the basis of an alleged violation of this statute." Id. at *3. The court thereafter dismissed the claims as precluded by SLUSA, but granted plaintiff leave to amend to avoid SLUSA preclusion. Id. at *8. However, plaintiff never amended the complaint, and the case thereafter was dismissed with prejudice.

(2) Even though the Ninth Circuit dismissed plaintiff's claims in Northstar Financial Advisors, Inc. upon holding that it lacked a private right of action under Section 13(a), the Circuit later allowed the case to proceed when it was re-filed alleging state law breach of contract and fiduciary duty claims, reversing the California district court's granting of a motion to dismiss the case. Northstar Fin. Advisors, Inc. v. Schwab Invs., 779 F.3d 1036 (9th Cir. 2015).

The shareholder class in that case alleged that the defendants Schwab Investments ("Schwab Trust"), a Massachusetts trust, its trustees, and Charles Schwab Investment Management ("Charles Schwab"), an investment adviser, had failed to comply with the fundamental investment objectives of the Schwab Total Bond Market Fund by investing heavily in mortgage-backed securities.

Specifically, the thrice-amended complaint alleged that the fund (1) failed to track the Lehman Brothers U.S. Aggregate Bond Index ("Lehman Index") and invested in risky non-U.S. agency collateralized mortgage obligations ("CMOs") that were not part of the Lehman Index, and (2) invested more than 25 percent of the Fund's total assets in a single industry through its investments in mortgage-backed securities and CMOs. Third Am. Compl. ¶ 5-6. Those alleged deviations from the fund's investment objectives – which had been approved by shareholder vote and reflected in subsequent registration statements and prospectuses – allegedly exposed the fund and shareholders to tens of millions of dollars in losses. Id. ¶ 7; Northstar Fin. Advisors, Inc., 779 F.3d at 1049.

After determining that Northstar had standing to bring the action, the court first held that Northstar stated a claim for breach of contract between the shareholders and the Schwab Trust, reversing the district court's dismissal of those claims. Id. at 1050-56. The court "conclude[d] that the mailing of the proxy statement and the adoption of the two fundamental investment policies after the shareholders voted to approve them, and the annual representations by the Fund that it would follow these policies are sufficient to form a contract between the shareholders on the one hand and the Fund and the Trust on the other." Id. at 1054. The court reasoned that by adopting the fund's investment objectives, the fund's shareholders had "added a structural restriction on the power conferred on the trustees … that can only be changed by a vote of the shareholders." Id. at 1051. The fund's representations therefore amounted to an offer to shareholders to invest on the terms provided, which shareholders accepted by investing in the fund. Id. at 1053-55.

Second, the Ninth Circuit vacated the district court's dismissal of Northstar's allegations that the trustees and Charles Schwab breached their duties to the shareholders by failing to manage the fund in accordance with fundamental investment objectives, and by changing those objectives without shareholder authorization. Id. at 1056-62. The court held that the trustees owed fiduciary duties to shareholders for two main reasons: (1) the Schwab Trust's governing documents that the trustees were to manage assets "for the pro rata benefit" of shareholders, id. at 1057, and (2) Massachusetts case law that it was "axiomatic" that trustees stand in a "fiduciary relationship

to all the beneficiaries of the trust." Id. (quoting Fogelin v. Nordblom, 521 N.E.2d 1007, 1011 (Mass. 1988).

The court rejected defendants' argument that Northstar was limited to a derivative action on the ground that, inter alia, a direct action is appropriate where a claim implicates a shareholder's contractual right. According to the court, two contractual rights were at issue: (1) the right to vote because fundamental investment objectives require shareholder vote to be changed and (2) "the contractual right to have the Fund managed in accordance with those objectives." Id. at 1058.

Furthermore, the court asserted that "the distinction between direct and derivative actions has little meaning in the context of mutual funds" because unlike corporations, mutual funds are focused only on investing assets to increase their value for the benefit of shareholders, and thus "the impact [of a breach] is directly on the investors in the Fund and a recovery would not be dependent on demonstrating an injury to the Schwab Trust." Id.

Third, the Ninth Circuit held that Northstar alleged a claim for breach of contract premised on the argument that shareholders are third-party beneficiaries of the Investment Advisory and Administration Agreement ("IAA") between the Schwab Trust and Charles Schwab. Id. at 1062-65. Recognizing that California courts have broadly interpreted third-party beneficiary law, the court found that shareholders amounted to "intended" beneficiaries of the agreement under California law, providing them with contractual rights to enforce the agreement. Id. at 1063. Notably, the court found "compelling evidence" that the agreement was intended to benefit shareholders because Congress required the agreement to be approved by a majority of the company's shareholders. Id. Further, even though the court conceded that California law required the shareholders to show that the IAA discharged a contractual duty owed to the shareholders, the court held that because Northstar adequately alleged that a contract existed between the Trust and investors, the IAA was "designed to discharge the Trust's duties to the shareholders under this contract." Id. at 1065.

The court did not determine whether the plaintiff's claims were preempted by SLUSA, which the district court had not reached in dismissing the case.

e. Conclusion

Since Olmsted, courts have almost uniformly barred private plaintiffs from bringing any actions based on alleged violations of any provisions of the ICA on the theory that those provisions provide for an "implied" private right of action. Nevertheless, private plaintiffs have had limited success in using other avenues – such as state law claims at issue in Smit and Northstar – to challenge alleged violations of provisions of the ICA that do not confer an express private right of action.

B. Section 36(a)—The Perceived Catchall

1. Legislative History

Section 36 as originally enacted in 1940 required a showing of "gross misconduct or gross abuse of trust." 15 U.S.C. § 80a-35 (1940). Under the gross abuse of trust standard, the Commission and courts were reluctant to impose liability upon a director of a mutual fund because such a finding connoted egregious wrongdoing by the directors, which would undoubtedly stigmatize them in the mutual fund industry. See Report of the SEC on the Public Policy Implications of Investment Company Growth, H.R. Rep. No. 2337, 89th Cong., 2d Sess. at 143 (1966) ("the Commission has been reluctant to stigmatize advisers with charges of gross abuse of trust solely because they have adhered to the traditional pattern of fee rates in the industry"); Senate Comm. of Banking & Currency, Investment Company Amendments Act of 1969, S. Rep. No. 184, 91st Cong., 1st Sess., at 36 (1969) ("the highly punitive overtones of the existing section, together with the injunctive penalty, seriously impairs the ability of the courts to deal flexibly and adequately with wrongdoing by certain affiliated persons of investment companies").

In 1970, Congress amended Section 36 to add a new section—Section 36(a)—which changed the standard from gross abuse of trust to "breach of fiduciary duty involving personal misconduct." The amendment was designed for the SEC to have more flexibility in bringing actions against investment advisers and directors without attaching the "gross abuse of trust" label.

The original version of Section 36(a) would have permitted the SEC to bring actions for breach of fiduciary duty alone. See S. 1659 and H.R. 9510. Congress, reacting to complaints of industry representatives that such a broad standard would lead to actions for even minor disagreements with the Commission, added the term "involving personal misconduct" in order to limit recoveries against advisers and directors to cases of self-dealing or some clear-cut personal impropriety. See Hearings of S. 1659 Before the Senate Committee on Banking and Currency, 90th Cong., 1st Sess. 167.

2. Judicial Evolution of Section 36(a)—The Changing Landscape

Historically, courts interpreting Section 36(a)'s "personal misconduct" standard have found a violation of the statute only in cases involving some type of self-interested behavior by a defendant. See, e.g., SEC v. Vintage Group, Inc., Litig. Release No. 14319, 1994 WL 615222 (N.D. Cal. Nov. 2, 1994) (enjoining defendants from future violations of Section 36(a) where they had misappropriated offering proceeds); SEC v. Strategic Mgmt., Inc., Litig. Release No. 13701, 1993 WL 268506 (N.D. Tex. July 9, 1993) (strategic violation of Section 36(a) for accepting $2 million payment for the sale of investment advisory contract), aff'd, No. 93-1707 (5th Cir. 1993); SEC v. Commonwealth Chem. Sec., Inc., 410 F. Supp. 1002 (S.D.N.Y. 1976) (self-dealing led to violation of 36(a)), aff'd in part, modified in part, 574 F.2d 90 (2d Cir. 1978).

Securities plaintiffs have tried to utilize Section 36(a) as a catch-all for any alleged bad acts by advisers, directors and managers. Unfortunately for securities defendants, some federal courts have taken a liberal view of what plaintiffs must allege to state a claim for "a breach of fiduciary duty involving personal misconduct" under this Section. Courts have in several cases been unwilling to dismiss Section 36(a) claims before trial—whether or not they are accompanied by specific allegations of self-dealing or personal impropriety by the defendants. Instead, some cases suggest that "ordinary" breaches of fiduciary duty may be sufficient to state a claim under Section 36(a). See, e.g., Young v. Nationwide Life Ins. Co., 2 F. Supp. 2d 914 (S.D. Tex. 1998) (Section 36(a)'s "personal misconduct" clause not limited to conduct constituting self-dealing or personal impropriety, but "any nonfeasance of duty or abdication of responsibility"); Seidel v. Lee, No. 94-422, 1996 WL 903947 (D. Del. Aug. 16, 1996) (allegations that independent general partners failed to adopt or implement procedures necessary to determine whether a transaction was prohibited could be a breach of fiduciary duty); In re Nuveen Fund Litig., No. 94 C 360, 1996 WL 328006 (N.D. Ill. June 11, 1996) (directors' abdication of responsibility to protect shareholders from the *adviser's* self-dealing constitutes violation of Section 36(a)); In re Nuveen Fund Litig., No. 94 C 360, 1996 WL 328003 (N.D. Ill. June 11, 1996) (allegations concerning directors conduct were sufficient to state a cause of action for "gross negligence"); Strougo v. Scudder, Stevens & Clark, Inc., 964 F. Supp. 783 (S.D.N.Y. 1997).

More recent cases, however, have rejected the "federalization" of common law breaches of fiduciary duty and, in line with Congress' specific language in the statute limiting actions to those involving "personal misconduct," have required an element of self dealing in claims brought under Section 36(a). For example, in Jacobs v. Bremner, 378 F. Supp. 2d 861 (N.D. Ill. 2005), the court held that neither the legislative history nor the statutory text of Section 36(a) supports the argument that Congress intended Section 36(a) to provide a general remedy for all breaches of fiduciary duty. "[C]ourts have typically read Section 36(a) claims to require 'some sort of element of self-dealing.'" Id. at 866 (quoting In re Nuveen Funds Litig., 1996 WL 328006, at *10-12). "After all, the statutory reference to

'a breach of fiduciary duty involving personal misconduct' would be patently redundant if 'personal misconduct' were read to encompass any general breach of a fiduciary duty." Jacobs, 378 F. Supp. 2d at 867. See also Prescott v. Allstate Life Ins. Co., 341 F. Supp. 2d 1023, 1029 (N.D. Ill. 2004) (dismissing claim under Section 36(a) because "personal misconduct" refers to "misconduct that involves self-dealing by investment company or other insiders" and plaintiffs "do not allege any self-dealing or even personal impropriety" by defendant); Brady v. Allstate Life Ins. Co., No. 04 C 2518, 2004 WL 2218372, at *2-3 (N.D. Ill. Oct. 1, 2004) (same).

Further, several cases have declined to find a private right of action under Section 36(a). See, e.g., Laborers' Local 265 Pension Fund v. iShares Trust, No. 3:13-cv-00046, 2013 WL 4604183 (M.D. Tenn. Aug. 28, 2013); Smith v. Oppenheimer Funds Distrib., Inc., Nos. 10 Civ. 7387, 10 Civ. 7394, 2011 U.S. Dist. LEXIS 60877, at *24, 27 (S.D.N.Y. June 6, 2011); Wiener v. Eaton Vance Distribs., Inc., No. 10-10515, 2011 WL 1233131, at *11-13 (D. Mass. Mar. 30, 2011); Alexander v. Allianz Dresdner Asset Mgmt. of Amer. Holding, Inc., et al., 509 F. Supp. 2d 190 (D. Conn. 2007); Boyce v. AIM Mgmt. Group, Inc., et al., No. H-04-2587, 2006 WL 4671324 (S.D. Tex. Sept. 29, 2006); Gilliam v. Fidelity Mgmt. & Research Co., et al., No 04-11600, slip op. (D. Mass. Sept. 18, 2006); In re Merrill Lynch Inv. Mgmt. Funds Sec. Litig., 434 F. Supp. 2d 233 (S.D.N.Y. 2006); In re BlackRock Mutual Funds Fee Litig., No. 04 Civ. 164, 2006 WL 4683167 (W.D. Pa. Mar. 29, 2006); In re Evergreen Mutual Funds Fee Litig., 423 F. Supp. 2d 249 (S.D.N.Y. 2006); In re Oppenheimer Funds Fee Litig., 419 F. Supp. 2d 593 (S.D.N.Y. 2006); Forsythe v. Sun Life Fin. Inc., 417 F. Supp. 2d 100 (D. Mass. 2006); In re Goldman Sachs Mutual Funds Fee Litig., No. 04 Civ. 2567, 2006 WL 126772 (S.D.N.Y. Jan. 16, 2006); Davis v. Bailey, No. 05CV42, 2005 WL 3527286 (D. Colo. Dec. 22, 2005); In re Am. Funds Mutual Funds Fee Litig., No. CV 04-5593, 2005 WL 3989803 (C.D. Cal. Dec. 16, 2005); Yameen v. Eaton Vance Distribs., Inc., 394 F. Supp. 2d 350 (D. Mass. 2005); In re Dreyfus Mutual Funds Fee Litig., 428 F. Supp. 2d 342 (W.D. Pa. 2005); Stegall v. Ladner, 394 F. Supp. 2d 358 (D. Mass. 2005); Hamilton v. Allen, 396 F. Supp. 2d 545 (E.D. Pa. 2005); In re Franklin Mutual Funds Fee Litig., 388 F. Supp. 2d 451 (D.N.J. 2005); In re Lord Abbett Mutual Funds Fee Litig., 385 F. Supp. 2d 471 (D.N.J. 2005); In re Mutual Funds Inv. Litig. (In re Janus Subtrack Investor Class Op.), 384 F. Supp. 2d 845 (D. Md. 2005); Dull v. Arch, No. 05 C 140, 2005 WL 1799270 (N.D. Ill. July 27, 2005); Jacobs v. Bremner, 378 F. Supp. 2d 861 (N.D. Ill. 2005); Mutchka v. Harris, 373 F. Supp. 2d 1021 (C.D. Cal. 2005); Chamberlain v. Aberdeen Asset Mgmt. Ltd., No. 02-CV-5870, 2005 WL 195520 (E.D.N.Y. Jan. 21, 2005), vacated solely for purposes of settlement, 2005 WL 1378757 (E.D.N.Y. Apr. 12, 2005).

3. Breach of Fiduciary Duty Cases Involving Board Actions

a. In Goldstein v. Lincoln Nat'l Convertible Sec. Fund, Inc., 140 F. Supp. 2d 424 (E.D. Pa. 2001), vacated in part, 2003 WL 1846095 (3d Cir. 2003), the court emphasized that Section 36(a) imposes a

federal standard for breach of fiduciary duty, but then went on to apply common law. The plaintiff shareholder was concerned because the Fund was trading at a discount to net asset value and asked the Fund's board of directors to consider nominating plaintiff as a director. The board instead nominated themselves, created staggered terms for its board members, and issued a proxy for the upcoming election. The board rejected plaintiff's attempt to nominate himself and submit proposed amendments to the bylaws on the ground that plaintiff's proposals had not been submitted prior to the Fund's advance notice deadline. Plaintiff then brought breach of fiduciary duty claims under Section 36(a) as well as Maryland state law.

After a bench trial, the court found that the board did breach its fiduciary duty, although it did not decide the issue directly under Section 36(a). It first noted that it would assume, without deciding, that a private right of action exists under Section 36(a). Id. at 436 n.7. The court then observed that Section 36(a) "imposes a federal standard for fiduciary obligations" which obligations were "'at least as stringent as those at common law.'" Id. at 436 (citation omitted). The court quoted from Section 36(a)'s legislative history which shows congressional intent "to impose liability on mutual fund managers if 'they engage in conduct which violates prevailing standards of fiduciary duty involving personal misconduct.'" Id. (citation omitted).

In light of Congress' reliance on "prevailing standards" and the parties' failure to brief the elements of a Section 36(a) claim, the court stated that it would not address the issue of whether Section 36(a) was violated, but instead addressed the issue under Maryland law. The court concluded that the board's decision to enforce the advance notice provision contained in the Fund's previous proxy statement and preclude the plaintiff from bringing his business to the shareholders' annual meeting could not be protected under Maryland's business judgment rule because that advance notice provision was not contained in the Fund's bylaws or charter. Id. at 440. Thus, the board had breached its fiduciary duty to the Fund's shareholders. Id.

b. In Navellier v. Sletten, 262 F.3d 923 (9th Cir. 2001), cert. denied, 536 U.S. 941 (2002), the Ninth Circuit affirmed nearly all aspects of a jury verdict for defendants in a case arising from a decision by the fund's independent directors to replace the fund's investment adviser. The fund was formed in 1993 and the initial term of its investment advisory contract with the advisor, NMI, was two years. In 1995, the independent directors hired independent counsel, Roy Adams, who advised them that they needed to obtain

certain financial information about NMI in order to fulfill their fiduciary obligations to the fund's shareholders in conducting their annual review of the investment advisory agreement. Independent counsel also expressed concern about the abilities of fund counsel, Sam Kornhauser, and the fact that Kornhauser also served as counsel to the adviser, NMI, and the affiliated directors. Id. at 932.

At an April 1996 board meeting, the affiliated directors proposed merging the fund into another fund. The independent directors deferred consideration of the merger proposal because they had no advance notice or information about that proposal. The next agenda item was approval of the investment advisory agreement, and the independent directors expressed their frustration because they had not received the requested information about NMI from NMI or Kornhauser. The independent directors then voted to remove Kornhauser as fund counsel. They further conditioned their consideration of the merger proposal on receiving financial information about affiliated director Navellier and his companies, which Navellier refused to provide. Id. at 933.

Subsequently, in March 1997 the independent directors voted not to renew NMI's investment advisory contract and instead hired MFS as the fund's adviser. In April 1997, the independent directors voted to remove Navellier and the other affiliated director and eliminated those board positions. In May 1997, the proposal to shareholders to retain MFS as an adviser failed to receive the required two/thirds of the shareholders' votes. Navellier refused to return to the fund unless the independent directors released him from liability and then resigned. The independent directors complied, returning management of the fund to NMI and resigning from the board. Id.

The fund shareholders, NMI, and the affiliated directors sued the independent directors, independent counsel Adams and MFS, alleging breach of fiduciary duty under the Act and common law. The Ninth Circuit affirmed the jury verdict for defendants on those claims.

First, it agreed that under California law, Adams, in advising the independent directors, owed no duty of care to the fund shareholders because they were not the intended beneficiaries of his counsel. Id. at 934-35.

Second, it agreed that MFS and its officer and director Scott owed no fiduciary duty to the fund shareholders when the independent directors decided to change investment advisers, and thus could not be liable under the Act for any breach of such a duty. It noted that

under Section 15(c) of the Act, decisions regarding the renewal of investment advisory contracts are within the sole discretion of a fund's independent directors, and that MFS did not become the fund's adviser until after the independent trustees decided not to renew NMI's contract. Similarly, Scott did not become a director of the fund until after that decision, and as an interested director the Act prohibits him from participating in any vote to retain or replace an investment adviser. Id. at 935-36. The Ninth Circuit concurred with the district court in rejecting plaintiffs' argument that MFS and Scott were acting as the fund's *de facto* adviser and director prior to their formal agreement to do so, finding it contrary to the plain language of Section 2 of the Act which defines advisory boards as "elected or appointed" and directors as those performing those functions of a director. Id.

Third, it concluded that MFS and Scott could not be liable under the Act for breach of fiduciary duty on the theory that they controlled the independent directors because the independent directors do not fall within the Act's definition of "controlled persons." Id. at 936.

Lastly, it concluded that MFS and Scott were not liable for breach of fiduciary duty under Delaware law, which requires claims for breach of a fiduciary relationship to stem from some actual, specific legal relationship, not its potential. The fact that MFS and Scott merely provided information about its services to the independent directors did not create a fiduciary duty between MFS and Scott and the Fund shareholders at the time the independent directors decided not to renew NMI's contract. Id. at 936-37. In addition, plaintiffs provided no facts to establish that MFS and Scott controlled the independent directors. Id. at 937.

V. LITIGATION ARISING UNDER OTHER LAWS

Although much litigation against investment advisers involves claims brought pursuant to various sections under the Act, many of the recent cases asserted by private litigants involve various other statutory schemes, including the 1933 and 1934 Acts, as well as ERISA. Of course, the mutual fund industry is also subject to comprehensive regulatory oversight.

A. The Securities Act of 1933

1. Duty to Disclose

a. In Benzon v. Morgan Stanley, No. 3:03-159, 2004 WL 62747 (M.D. Tenn. Jan. 8, 2004), plaintiffs brought claims under the 1933 Act, the 1934 Act, and common law against the fund's adviser alleging that the fund's prospectus failed to disclose the relative

merits of purchasing Class A shares versus Class B shares. Specifically, plaintiffs claimed that defendants had a duty to disclose in the prospectus that investing in Class B shares was never "the best choice for any rational investment strategy." Id. at *1. In finding that defendants had no duty to make such statements about Class B shares in the prospectus, the court stated:

> [t]he prospectus at issue discloses information which would permit any investor to determine the "best" investment for him or her, under the circumstances. It is up to each investor to take the facts provided, evaluate options, make calculations, and decide on the best investment strategy for his or her particular circumstances, taking into account the myriad changes which occur daily, both in the market and in the individual's own financial situation. See Wallerstein v. Primerica Corp., 701 F. Supp. 393, 398 (E.D.N.Y. 1988) ("Full factual disclosures need not be embellished with speculative financial predictions."). So long as Defendants provide truthful information, then investors, with or without financial advisors, have the duty to decide was [sic] is "best" for them.

Id. at *4. The court noted that the prospectus disclosed the total amounts paid by investors to defendants for the various classes of shares and, thus, defendants "had no duty to provide more specific information in the prospectus concerning specific allocations or incentives given to brokers" for selling those different classes of shares. Id. Thus, the court granted defendants' motion to dismiss.

Plaintiffs appealed the district court ruling. See Benzon v. Morgan Stanley Distribs., Inc., 420 F.3d 598 (6th Cir. 2005). In sustaining dismissal, the court noted that although defendants had no duty to disclose information about broker compensation, even if such a duty existed, the information contained in the subject prospectus did, in fact, address the purported omitted material. See id. at 612.

b. In In re Merrill Lynch Investment Management Funds Securities Litigation, 434 F. Supp. 2d 233 (S.D.N.Y. 2006), plaintiffs alleged that Merrill Lynch and related defendants entered into agreements with certain mutual funds pursuant to which Merrill Lynch received payments from the funds in exchange for providing financial and other incentives to its sales force to sell the funds. Plaintiffs claimed that these distribution arrangements and Merrill Lynch's failure to disclose them constituted violations of Sections 12 and 15 of the 1933 Act; Sections 10(b) and 20(a) of the 1934 Act; Sections 34(b), 36(a), 36(b), and 48(a) of the Act; Sections 206 and 215 of the Investment Advisers Act of 1940; and state

law. Defendants moved to dismiss the complaint in toto. The district court granted the motion, noting that defendants did not violate their duty to disclose because they "disclosed the fees and commissions charged to shareholders . . . [and the] precise allocation of those fees is not material under the securities laws." Id. at 238. The court also noted that when a claim brought pursuant to the 1933 Act is "premised on averments of fraud, the heightened pleading requirements of Rule 9(b) apply." Id. at 239 (citations omitted). Finding that the complaint sounded in fraud, the court held that plaintiffs failed to meet this bar as plaintiffs failed to identify "a single statement, by any broker to an investor or otherwise, which is misleading." Id. at 239.

c. In In re Morgan Stanley & Van Kampen Mutual Fund Securities Litigation, No. 03 Civ. 8208, 2006 2006 WL 1008138 (S.D.N.Y. Apr. 18, 2006), plaintiffs brought a myriad of claims relating to Morgan Stanley's revenue sharing program. According to plaintiffs, Morgan Stanley provided incentives to its sales force of registered representatives to promote the sale of its proprietary funds. Plaintiffs claimed that these sales incentives and Morgan Stanley's failure to disclose them constituted violations of Sections 11, 12 and 15 of the 1933 Act; Sections 10(b) and 20(a) of the 1934 Act; Sections 34(b), 36(b), and 48(a) of the Act; Sections 206 and 215 of the Investment Advisers Act of 1940; and state law. Defendants moved to dismiss the complaint in its entirety. After analyzing the standards by which 1933 Act claims are judged, the court found that defendants did not violate any purported duty to disclose the details of its revenue sharing program, noting that "current SEC regulations impose[d] no duty on defendants to disclose the allocation of broker compensation." Id. at *7. Citing Benzon v. Morgan Stanley Distributors, Inc., 420 F.3d 598 (6th Cir. 2005), the court held that since defendants had disclosed the total fees to be paid by investors, as well as the total commissions paid by the fund, defendants had abided by their duty to disclose. See id. at *7-8.

d. In Siemers v. Wells Fargo & Co., No. C 05-4518, 2006 WL 2355411 (N.D. Cal. Aug. 14, 2006), plaintiff asserted numerous claims relating to Wells Fargo's revenue sharing program. According to plaintiff, Wells Fargo and certain related defendants engaged in a purportedly undisclosed "scheme" to pay unaffiliated third party broker-dealers in an effort to induce their customers into purchasing Wells Fargo-branded mutual funds. Plaintiff alleged that he was harmed by: (1) receiving biased advice from broker-dealers; and (2) the dissipation of fund assets by paying purportedly "excessive" fees to the investment adviser and distributor defendants. Plaintiff claimed that these "kickback"

arrangements and Wells Fargo's failure to disclose them constituted violations of Sections 12 and 15 of the 1933 Act; Sections 10(b) and 20(a) of the 1934 Act; and Sections 36(b) and 48(a) of the Act. With respect to the 1933 Act claims, plaintiff alleged that defendants had a duty to disclose the exact nature of the payment arrangements with unaffiliated broker-dealers. Specifically, plaintiff complained of defendants' representation that they "may consider sales of shares of the Fund . . . in the selection of broker-dealers to execute the Fund's portfolio transactions." Id. at *5 (quotation omitted). The court agreed, noting that such a representation by defendants violated their duty to disclose, as the representation contained in the prospectus "left the impression that the payback arrangement might (or might not) materialize when it was, in reality, already a done deal." Id. at *5.

e. In Ulferts v. Franklin Resources, Inc., 554 F. Supp. 2d 568 (D.N.J. 2008), shareholders of several mutual funds alleged defendants failed to disclose a compensation scheme that caused unaffiliated broker-dealers to steer unwitting investors into Franklin-branded mutual funds. Specifically, plaintiffs alleged that the brokerage fees charged to the funds were improperly used to finance shelf-space arrangements to steer additional investors into defendants' funds. Plaintiffs claimed defendants' conduct violated Section 12(a)(2) of the 1933 Act; and Section 10(b) of the 1934 Act. Defendants moved to dismiss the complaint in its entirety, including plaintiffs' 1933 Act claims. The court granted the motion, noting that plaintiffs' complaint was devoid of any allegations that defendants' disclosures contained misleading information that necessitated disclosure. Id. at 575 (citing Benzon v. Morgan Stanley Distribs., Inc., 420 F.3d 598, 612 (6th Cir. 2005)). Further, the court found that, irrespective of plaintiffs' allegations, the complained-of conduct was not required to be disclosed either by statute or regulation. Id. at 575-76 (citing In re AIG Advisor Group, No. 06-CV-1625, 2007 WL 1213395, at *9 (E.D.N.Y. Apr. 25, 2007); In re Morgan Stanley & Van Kampen Mutual Fund Sec. Litig., No. 03 Civ. 8208, 2006 WL 1008138, at *7 (S.D.N.Y. Apr. 18, 2007)).

On June 30, 2008, the court denied plaintiffs' motion for reconsideration or for leave to file an amended complaint. Ulferts v. Franklin Resources, Inc., 567 F. Supp. 2d 678, 682 (D.N.J. 2008). Plaintiffs argued that defendants were required to disclose shelf-space arrangements pursuant to SEC Form N1-A, and that their failure to do so was a violation of Section 12(a)(2) of the 1933 Act. Id. at 680. Alternatively, plaintiffs asked the court to grant them leave to amend their complaint to incorporate purportedly misleading portions of the funds' prospectuses

describing shelf-space arrangements. Id. at 681-82. The court rejected both arguments, holding that Form N1-A required defendants to include details of the shelf-space arrangements only to the extent shareholders requested a Statement of Additional Information and that, regardless, defendants accurately disclosed these arrangements in the funds' prospectuses. Id.

f. In Garber v. Legg Mason, Inc., 537 F. Supp. 2d 597 (S.D.N.Y. 2008), the district court dismissed investors' claims against Legg Mason and a number of its officers. Plaintiffs alleged violations of Sections 11, 12(a)(2) and 15 of the 1933 Act; and Sections 10(b) and 20(a) of the 1934 Act, stemming from purported misrepresentations made by defendants with respect to the share price of a secondary offering of Legg Mason common stock following its acquisition in an asset swap of substantially all of Citigroup's worldwide asset management division. Id. at 604-09. Specifically, plaintiffs alleged that the registration statement for the secondary offering and announcements made after the offering omitted or misrepresented several matters, including: (1) that one of Legg Mason's top asset managers was leaving the firm following the asset swap; (2) that Legg Mason was experiencing a significant increase in customer withdrawals as a result of broker attrition due to the asset swap; (3) that Legg Mason was experiencing a dramatic increase in expenses in integrating the Citigroup infrastructure; and (4) that Legg Mason owed and failed to pay approximately $12 million in distribution fees owed by one of the Citigroup entities acquired in the swap. Id. at 607-08. The district court held that Legg Mason's prospectus provided adequate disclosure of the first two alleged misrepresentations. Id. at 612-13. Additionally, the court held that disclosure of the unpaid distribution fees was not required. Id. at 614. Judge Chin's decision was subsequently affirmed by the Second Circuit. See Garber v. Legg Mason, Inc., 347 F. App'x 665 (2d Cir. 2009).

g. In Hoffman v. UBS-AG, 591 F. Supp. 2d 522 (S.D.N.Y. 2008), investors in various UBS mutual funds brought a putative class action against, inter alia, UBS's affiliated broker-dealer, alleging violations of Sections 12(a)(2) and 15 of the 1933 Act; Sections 10(b) and 20(a) of the 1934 Act; and Section 36(b) of the Act. With respect to the 1933 Act and the 1934 Act, plaintiffs alleged that the broker-dealer failed to disclose to investors that: (1) its internal compensation structure encouraged individual financial advisors to steer investors into purchasing certain UBS proprietary funds, as well as certain additional consulting services provided by UBS; and (2) that certain of the UBS advisors were incentivized to sell "Tier I" mutual funds because those mutual fund families engaged in "revenue sharing" with the UBS broker-dealer entity.

Id. at 528. Judge Sand granted defendants' motion to dismiss. In particular, the court held it was settled law that defendants were under no duty to disclose the financial advisors' compensation structure. Id. at 533. In addition, Judge Sand also rejected plaintiffs' argument that SEC Form N1-A required defendants to disclose "all the details of its shelf-space agreements," citing Ulferts v. Franklin Resources, Inc., 567 F. Supp. 2d 678 (D.N.J. 2008). Id. at 533-34. Judge Sand found that the funds' prospectuses "disclosed that they might enter into [shelf-space agreements]," and, as such, "were not misleading or incomplete to the extent that they disclosed [such a] possibility." Id. However, the court left open the question as to "whether a securities violation would occur if a defendant failed to disclose the fact that the fund *may* enter into a shelf-space fund agreement." Id. at 534 (emphasis in original).

h. In In re Morgan Stanley Technology Fund Securities Litigation, 643 F. Supp. 2d 366 (S.D.N.Y. 2009), Judge Jones dismissed plaintiffs' claims under Sections 11, 12(a)(2) and 15 of the 1933 Act. Plaintiffs alleged that Morgan Stanley failed to appropriately disclose conflicts of interest between Morgan Stanley's research analysts and its investment banking division, and certain IPO practices that allegedly inflated the price of shares held by the two mutual funds at issue. After analyzing various statutes, regulations and other disclosure requirements, including SEC Form N1-A, Section 17 of the Act (and its accompanying regulations), Rule 10f-3 under the Act, and Regulation M under the 1934 Act, Judge Jones held that Morgan Stanley was not required to disclose either of these alleged misstatements or omissions. Id. at 375-80.

On January 25, 2010, the Second Circuit affirmed Judge Jones' dismissal of plaintiffs' claims under Sections 11, 12(a)(2) and 15 of the 1933 Act. See In re Morgan Stanley Info. Fund Sec. Litig., 592 F.3d 347 (2d Cir. 2010). With regard to Form N-1A, the court requested that the SEC submit an amicus curiae brief. As expected, the Second Circuit deferred to the SEC's interpretations. First, the court deferred to the SEC's interpretation that the General Instructions to Form N-1A "are not an independent source of disclosure obligations . . . beyond those specified in the instructions relating to Parts A, B, and C of the Form." Id. at 361 (citation omitted). As such, the "General Instructions . . . did not require defendants to disclose the allegedly omitted information . . . ." Id. at 362. Second, the court deferred to the SEC's interpretation that under Items 2 and 4 of Part A of the Form, that defendants are only required to disclose risk factors that are specific to the fund at issue. Id. at 362-63. Accordingly, the court held that defendants abided by their duty to disclose because "all

investors, including the Funds' managers, face the risk that the research they use to make their decisions may be biased or flawed . . . [and] plaintiffs' allegations do not support an inference that the Funds' managers made investment decisions under circumstances that gave rise to unique, undisclosed risks relating to the Funds." Id. at 363-64.

The court also rejected plaintiffs' contentions that defendants breached their obligations under Sections 11 and 12(a)(2) of the 1933 Act and SEC Rule 408, as defendants' disclosures in the offering documents "did not trigger a generalized duty . . . to disclose the entire corpus of their knowledge regarding" Morgan Stanley's broker-dealer subsidiaries. Id. at 366. As a result, since plaintiffs failed to identify "any undisclosed 'principal risks' relating to the Funds, it cannot be said that the Offering Documents' risk disclosures were misleading because they omitted the generic risk relied on by plaintiffs." Id.

i. In Goldenberg v. Indel, Inc., 741 F. Supp. 2d 618 (D.N.J. 2010), plaintiffs alleged that defendants violated Section 12(a)(2) of the 1933 Act because a chart in a money market mutual fund prospectus showing the annual operating expenses of the fund did not include a .22% shareholder service fee paid to a servicing agent. See id. at 642. On a motion to dismiss, defendants argued that the .22% fee was included as part of the "Other Expenses" listed in the chart, and in any case the fee was specifically disclosed in the prospectus. The court concluded that a reasonable investor not only would expect that the fee would be included as part of the "Other Expenses," but would also have read the whole prospectus and would have known about the fee. Id. "In light of the later explicit disclosure of the fee, and the likely inference that the fee was included in 'Other Fees,' Plaintiffs fail to state a claim for violation of [Section 12(a)(2)]." Id.

j. In Zametkin v. Fidelity Management & Research Co., No. 1:08-CV-10960, Transcript of Hearing, (D. Mass. Nov. 15, 2010), an investor in the Fidelity Ultra-Short Bond Fund filed suit against the fund's investment adviser, its affiliate, several other Fidelity funds and the funds' independent trustees alleging violations of Sections 11, 12, and 15 of the 1933 Act. Specifically, plaintiff alleged that defendants mismanaged the fund and violated its investment policies through heavily investing in mortgage securities, which led to a fifteen percent decline in the fund's return. Stressing that Rule 9 of the Federal Rules of Civil Procedure did not apply to the case, Judge Wolf sustained plaintiff's Sections 12 and 15 claims on the basis that Fidelity's disclosure that it employed "sophisticated" techniques to evaluate mortgage securities was contradicted by the

allegations of a confidential witness. Id. at 87. Judge Wolf also analogized plaintiff's claims to those sustained in Yu v. State Street Corp., No. 08 Civ. 8235, 2010 WL 2816259 (S.D.N.Y. July 14, 2010), and noted that plaintiff alleged that up to "78 percent of the investments were mortgage related . . . and it is plausible that it could be concluded that that was not adequately disclosed." Zametkin at 90. This case later settled. See Zametkin v. Fidelity Mgmt. & Research Co., No. 1:08-CV-10960, Order Approving Settlement (D. Mass. May 4, 2012).

k. In Rafton v. Rydex Series Funds, No. 10 CV 01171, 2011 WL 31114 (N.D. Cal. Jan. 5, 2011), plaintiffs filed a putative class action asserting claims under Sections 11, 12(a)(2) and 15 of the 1933 Act. Plaintiffs, investors in the Rydex Inverse Government Long Bond Strategy Fund, alleged that the fund's offering documents were materially misleading "by misrepresenting who was an appropriate investor in the Fund [i.e., daily vs. long-term] and by failing to adequately disclose a 'mathematical compounding effect' that would cause the Fund to deviate from its benchmark, the inverse price of the 30-Year U.S. Treasury Bond." Id. at *1. The court ruled that plaintiffs had stated a claim because defendants "marketed their Fund as a way to profit from a decline in the value of the 30-year U.S. Treasury bond, but did not specify that the Fund was only appropriate for investors who thought the value of the 30-year Treasury bond would fall *that day* and discouraged investors from selling shares over the shorter term with sales charges for shares sold within a year or eighteen months of purchase . . . ." Id. at *7 (emphasis in original). Notably, the court found that defendants' disclosures were insufficient to sustain a motion to dismiss because they relied on "conditional language" regarding the effect of compounding. The court stated, however, that this "is more than a dispute over adverbs . . . [as] Defendants failed to disclose the magnitude of the risk they faced by holding the Fund for longer than a single day because of the inevitable effect of compounding." Id. at *8 (citations omitted). This case later settled. See Rafton v. Rydex Series Funds, No. 10 CV 01171, Final Judgment and Order of Dismissal (N.D. Cal. Feb. 10, 2012).

l. In In re Oppenheimer Rochester Funds Group Securities Litigation, 838 F. Supp. 2d 1148 (D. Colo. 2012), investors in seven Oppenheimer municipal bond funds brought suit under Sections 11, 12 and 15 of the 1933 Act. Plaintiffs alleged that while the funds were marketed as "stable income-seeking investments that also focused on the preservation of investors' capital," the funds in reality invested in illiquid bonds or highly-leveraged derivatives. Plaintiffs contended that the funds'

disclosures "were materially misleading and rendered investors' capital extremely vulnerable to changing market conditions. When the credit crisis of 2008 struck, Defendants' undisclosed high-risk strategies resulted in an extreme devaluation of the Funds' assets . . . ." Id. at 1152.

In denying defendants' motion to dismiss, the court found that plaintiffs had stated a claim with regard to the funds' investment in highly-leveraged derivatives known as "inverse floaters." Plaintiffs alleged that defendants did not disclose "how leveraged these floaters were and as a result of this leveraging how hyper-sensitive they were to changes in the bond market." Id. at 1163. The court rejected defendants' argument that the funds' disclosures provided investors with the data necessary to calculate the leverage ratio, and found that "[m]eaningful disclosure of a Fund's volatility and risk is not about mathematical precision or who bears the burden of quantifying it." Id. at 1165. Rather, the funds' failure "to disclose even a general range of inverse floater leverage ratios plausibly left out information reasonable investors would have deemed important to their decision" to invest in the funds at issue. Id.

On March 12, 2014, the court offered its preliminary approval of a settlement between the parties. A settlement hearing is scheduled for July 31, 2014.

m. In In re Direxion Shares ETF Trust, 279 F.R.D. 221 (S.D.N.Y. 2012), investors in several funds that sought a daily investment return of three times the inverse of a certain index brought suit against the funds' investment adviser, its affiliate, and the funds' independent trustees alleging violations of Sections 11 and 15 of the 1933 Act. Specifically, plaintiffs alleged that defendants' initial disclosures "did not disclose that holding shares in the Funds for longer than a single day could result in significant loss." Id. at 226. The court rejected defendants' motion to dismiss because "although the [initial disclosures] contained a number of references to the 'daily' nature of the Funds, they also contained contra-indicators, signifying that holding for longer than a single day was appropriate. For example, defendants point to the [initial disclosures] to support their argument that the Funds were 'short term investment vehicles' that sought 'daily returns.' But that same warning states, 'Further, pursuit of *daily* leveraged investment goals means that the return of a Fund *for a period longer than a single day* will be the product of the series of daily leveraged returns for each day during the relevant period.' Those two statements taken together certainly do not indicate that holding for longer than a single day is inappropriate and/or may impair an

investor's ability to profit from their investment in the Funds." Id. at 232 (emphasis in original). The court later approved a class action settlement of $8 million.

n. In In re ProShares Trust Securities Litigation, 728 F.3d 96 (2d Cir. 2013), investors in several ProShares ETFs brought suit under Sections 11 and 15 of the 1933 Act. "'The [t]hrust of the plaintiffs' Section 11 claim is that the registration statements omitted the risk that the ETFs, when held for a period of greater than one day, could lose substantial value in a relatively brief period of time, particularly in periods of high volatility.'" Id. at 102 (quoting In re ProShares Trust Sec. Litig., 889 F. Supp. 2d 644, 654 (S.D.N.Y. 2012)). The Second Circuit affirmed the district court's decision granting defendants' motion to dismiss. The court emphasized that "[b]ecause one might expect the long-term value of an ETF to correlate with the long-term value of its underlying index, ProShares warned that the actual results might *diverge significantly* from that prediction." ProShares, 728 F.3d at 103 (emphasis added). Although plaintiffs argued that ProShares should have warned that investors could suffer an "actual loss" if they did not heed the funds' short-term strategy, the court found that "ProShares' 'significant divergence' disclosures, fairly read, put investors on notice that an ETF's value might move in a direction quite different from and even contrary to what an investor might otherwise expect" if the shares were held for longer than a day. Id.

Like the district court, the Second Circuit also rejected allegations concerning "the existence of [an] undisclosed mathematical formula" bearing on the probability of plaintiffs' long-term losses. Id. at 104. The court found that "[a]ssuming, *arguendo*, that ProShares possessed an undisclosed mathematical formula . . . Plaintiffs' argument amounts to nothing more than an allegation that ProShares failed to disclose that the more an ETF's underlying index changed value day-to-day for a particular investor, the more likely it became that the investor would experience long-term losses depending on when she invested. That does not constitute an actionable omission of an objective fact. . . . ProShares cannot be expected to predict and disclose all possible negative results across any market scenario." Id. at 104-05.

The court separately addressed plaintiffs' allegations that ETF hypothetical investment cost tables provided by ProShares for various time periods "misleadingly implied that ProShares ETFs were suitable . . . investments" for those time periods. The court affirmed the district court's judgment that the "various projections

. . . fall far short of undercutting the emphasis on the daily nature of the ETFs." Id. at 106 (internal quotation omitted).[22]

Plaintiffs' also argued that a ProShares prospectus included correlation-risk disclosures "which included misleading line-graph examples that misled them" as to the divergence between the ETF's value and that of its underlying index. Unpersuaded, the court concluded that "the addition of the line graphs" was not misleading and "agree[d] with the district court that this one-year representation does not undercut the representations throughout the rest of the prospectuses." Id. at 107-8.

The court also held that the fact that ProShares updated its disclosures to include more information beginning on the last day of the class period was irrelevant, because "[t]o hold an issuer who alters disclosures deemed adequate in the first instance suddenly liable because it found a better way to say what has already been said would perversely incentivize issuers not to strive for better, clearer disclosure language." Id. at 109.

2. Materiality

a. In Benzon v. Morgan Stanley, No. 3:03-159, 2004 WL 62747 (M.D. Tenn. Jan. 8, 2004), plaintiffs brought claims under the 1933 Act, the 1934 Act, and common law against the fund's adviser alleging that the fund's prospectus failed to disclose the relative merits of purchasing Class A shares versus Class B shares. Specifically, plaintiffs claimed that defendants had a duty to disclose in the prospectus that investing in Class B shares was never "the best choice for any rational investment strategy." Id. at *1. Defendants moved to dismiss the complaint in its entirety. The court granted the motion, holding, inter alia, that the alleged omissions were not material as a matter of law.

Plaintiffs appealed the district court's dismissal. See Benzon v. Morgan Stanley Distribs., Inc., 420 F.3d 598 (6th Cir. 2005). While the Sixth Circuit found that the alleged merits of purchasing Class A shares versus Class B shares might have been useful, the

[22] The Second Circuit disagreed with the district court's alternative line of reasoning—that because "Form N–1A required disclosure of that exact information, ProShares could not expect that the SEC would require that information be specifically identified, qualified, or tempered." ProShares, 728 F.3d at 106 (internal quotation omitted). On this point the court noted that, "[w]hile Form N–1A requires the allegedly misleading table, it also requires this information to be in plain English under rule 421(d) under the Securities Act. . . . Accordingly, there remains a possibility that an issuer might present required information in a misleading manner. That, however, is not this case." Id. at 106 n.5 (internal citation omitted).

court concluded that since the omissions were "merely interpretations drawn from the facts presented in the prospectuses . . . they would not have significantly altered the total mix of the information already presented." Id. at 608. As a result, the court affirmed the lower court's dismissal of the complaint. See id.

b. In In re Merrill Lynch Investment Management Funds Securities Litigation, 434 F. Supp. 2d 233 (S.D.N.Y. 2006), plaintiffs alleged Merrill Lynch and related defendants entered into agreements with certain mutual funds pursuant to which Merrill Lynch received payments from the funds in exchange for providing financial and other incentives to its sales force to sell the funds. Plaintiffs claimed that these distribution arrangements and Merrill Lynch's failure to disclose them constituted violations of Sections 12 and 15 of the 1933 Act; Sections 10(b) and 20(a) of the 1934 Act; Sections 34(b), 36(a), 36(b), and 48(a) of the Act; Sections 206 and 215 of the Investment Advisers Act of 1940; and state law. Defendants moved to dismiss plaintiffs' claims. The court granted the motion, noting that defendants "disclosed the fees and commissions charged to shareholders . . . [and the] precise allocation of those fees is not material under the securities laws." Id. at 238.

c. In In re Morgan Stanley & Van Kampen Mutual Fund Securities Litigation, No. 03 Civ. 8208, 2006 WL 1008138 (S.D.N.Y. Apr. 18, 2006), plaintiffs brought a myriad of claims relating to Morgan Stanley's revenue sharing program. According to plaintiffs, Morgan Stanley provided incentives to its sales force of registered representatives to promote the sales of its proprietary funds. Plaintiffs claimed that these sales incentives and Morgan Stanley's failure to disclose them constituted violations of Sections 11, 12 and 15 of the 1933 Act; Sections 10(b) and 20(a) of the 1934 Act; Sections 34(b), 36(b), and 48(a) of the Act; Sections 206 and 215 of the Investment Advisers Act of 1940; and state law. Defendants moved to dismiss the complaint in its entirety, including plaintiffs' 1933 Act claims. After analyzing the standards by which 1933 Act claims are judged, the court found that defendants were under no obligation to disclose its sales practices and corresponding payments to its sales force because "minimum payments . . . are not material under the securities laws." Id. at *8 (citing Feinman v. Dean Witter Reynolds, Inc., 84 F.3d 539, 541 (2d Cir. 1996)). Since the participation fees and sales contests "were primarily of minimum value" and plaintiffs failed to allege "that the proportion of sales of proprietary funds had a more than minimal impact on the amounts of [an advisor's] bonus," defendants' omissions were not material. See id. at *8.

d. In Siemers v. Wells Fargo & Co., No. C 05-4518, 2006 WL 2355411 (N.D. Cal. Aug. 14, 2006), plaintiff asserted numerous claims relating to Wells Fargo's revenue sharing program. According to plaintiff, Wells Fargo and certain related defendants engaged in a purportedly undisclosed "scheme" to pay unaffiliated third party broker-dealers in an effort to induce their customers into purchasing Wells Fargo-branded mutual funds. Plaintiff alleged that he was harmed by: (1) receiving biased advice from broker-dealers; and (2) the dissipation of fund assets by paying purportedly "excessive" fees to the investment adviser and distributor defendants. Plaintiff claimed that these "kickback" arrangements and Wells Fargo's failure to disclose them constituted violations of Sections 12 and 15 of the 1933 Act; Sections 10(b) and 20(a) of the 1934 Act; and Sections 36(b) and 48(a) of the Act. With respect to plaintiff's 1933 Act claims, plaintiff alleged that defendants had a duty to disclose the exact nature of the payment arrangements with unaffiliated broker-dealers. Defendants moved to dismiss the complaint in toto, including the 1933 Act claims. The court denied the motion, holding that the alleged misstatement "left the impression that the payback arrangement might . . . materialize when it was, in reality, already a done deal." Id. at *5. The court found this misstatement to be material because a "reasonable investor is more likely to view the broker-dealer's recommendation with skepticism if he . . . knows for sure that the broker-dealer's objectivity has already been compromised, as opposed to the mere possibility that the broker-dealer's objectivity might . . . be compromised." Id. at *6.

e. In Garber v. Legg Mason, Inc., 537 F. Supp. 2d 597 (S.D.N.Y. 2008), the district court dismissed investors' claims against Legg Mason and a number of its officers. Plaintiffs alleged violations of Sections 11, 12(a)(2) and 15 of the 1933 Act; and Sections 10(b) and 20(a) of the 1934 Act, stemming from purported misrepresentations made by defendants with respect to the share price of a secondary offering of Legg Mason common stock following Legg Mason's acquisition of substantially all of Citigroup's worldwide asset management division. Id. at 604-09. Specifically, plaintiffs alleged that the secondary offering's registration statement and announcements, made after the offering, omitted or misrepresented several matters, including: (1) that one of Legg Mason's top asset managers was leaving the firm following the asset swap with Citigroup; (2) that Legg Mason was experiencing a significant increase in customer withdrawals as a result of broker attrition due to the asset swap; (3) that Legg Mason was experiencing a dramatic increase in expenses in integrating the Citigroup infrastructure; and (4) that Legg Mason owed and failed to pay approximately $12 million in distribution fees owed by one

of the Citigroup entities that Legg Mason acquired. Id. at 607-08. With respect to the integration expenses, Judge Chin held that plaintiffs' complaint was "too conclusory" to assess its materiality. Id. at 613. Additionally, the court held the unpaid $12 million in distribution fees to be "too small to be material as a matter of law." Id. Judge Chin's decision was subsequently affirmed by the Second Circuit. See Garber v. Legg Mason, Inc., 347 F. App'x 665 (2d Cir. 2009).

f. In Hoffman v. UBS-AG, 591 F. Supp. 2d 522 (S.D.N.Y. 2008), investors in various UBS mutual funds brought a putative class action against, inter alia, UBS's affiliated broker-dealer, alleging violations of Sections 12(a)(2) and 15 of the 1933 Act; Sections 10(b) and 20(a) of the 1934 Act; and Section 36(b) of the Act. With respect to the claims brought under the 1933 Act and the 1934 Act, plaintiffs alleged that the broker-dealer failed to disclose to investors that: (1) its internal compensation structure encouraged individual financial advisors to steer investors into purchasing certain UBS proprietary funds, as well as certain additional consulting services provided by UBS; and (2) that certain of the UBS advisors were incentivized to sell because "Tier I" mutual fund families engaged in "revenue sharing" with the UBS broker-dealer entity. Id. at 528. Judge Sand granted defendants' motion to dismiss. After holding that defendants had no duty to disclose either the compensation structure or the "revenue sharing" arrangement, Judge Sand found that defendants' omissions were not material, and, as such, did not trigger a duty to disclose. Id. at 535-36. In particular, Judge Sand cited In re Morgan Stanley for the proposition that "nominal incentives to brokers and financial advisors to sell a particular group of funds are immaterial." Id. The court held that the present facts did not lead to a different result, especially because plaintiffs failed to specifically allege what the financial advisors stood to gain from the revenue sharing program. Id. at 536.

g. In In re Morgan Stanley Technology Fund Securities Litigation, 643 F. Supp. 2d 366 (S.D.N.Y. 2009), Judge Jones dismissed plaintiffs' claims under Sections 11, 12(a)(2) and 15 of the 1933 Act. Plaintiffs alleged that Morgan Stanley failed to appropriately disclose conflicts of interest between Morgan Stanley's research analysts and its investment banking division, and certain IPO practices that allegedly inflated the price of shares held by the two mutual funds at issue. After holding that plaintiffs failed to introduce any regulatory or judicial authority that required defendants to disclose these facts, Judge Jones also found that the allegedly omitted information was not material, and that the funds' prospectuses accurately disclosed all relevant information. Id. at

380-81. On January 25, 2010, the Second Circuit affirmed Judge Jones's dismissal of plaintiffs' claims under Sections 11, 12(a)(2), and 15 of the 1933 Act. See In re Morgan Stanley Info. Fund Sec. Litig., 592 F.3d 347 (2d Cir. 2010).

h. In Yu v. State Street Corp., 686 F. Supp. 2d 369 (S.D.N.Y. 2010), Judge Holwell dismissed a putative class action asserting claims under Sections 11, 12(a)(2) and 15 of the 1933 Act. Plaintiff, an investor in the Yield Plus Fund, alleged that the fund's offering documents were materially misleading because they: (1) described the fund as one that invested in "high quality" securities; (2) classified certain mortgage-related holdings as "asset-backed" rather than "mortgage-backed" securities; and (3) overstated the value of the fund's mortgage-related securities. Defendants moved to dismiss the complaint. The court held that plaintiffs had failed to plead any actionable misrepresentations.

With respect to the offering documents' description of the fund's investments as "high quality," the court found that this term was used "specifically to describe the relative credit grade of the Fund's holdings" and not, as plaintiffs suggested, as a "guarantee that investors would not suffer losses." In support of this position, the court noted that the prospectus stated that the fund was designed to "seek high current income," not preserve capital. See id. at 375-76.

The court thereafter found that plaintiffs had failed to plead that the statement was false, since plaintiffs did not allege that the contents of the Fund's portfolio were not "high quality." In doing so, the court also rejected plaintiffs' argument that this "high quality" description "conflicted with contemporaneous market information about the developing subprime mortgage crisis," since "investors are presumed to be aware of public information concerning market trends." Id. at 377.

Second, the court found that a table in the fund's annual reports showing the fund's holdings by asset class as a percentage of the Fund's overall portfolio was not materially misleading even though plaintiffs alleged that certain securities should have been categorized as "mortgage backed" instead of "asset backed." The court held that the complaint contained no allegations that the table "had the effect of cloaking particularly risky mortgage securities within a category of safer bets, or whether the asset-backed securities . . . were on the whole riskier than the mortgage-related subcategory." Id. at 378. Moreover, given the "total mix" of information when reviewing the document "as a whole," which included detailed schedules of the names of the securities in each

asset class, the court found that "it would not be reasonable for an investor to believe that the 'Mortgage-Backed Securities' category represented the extent of the Fund's mortgage holdings." Id.

Finally, with respect to plaintiffs' allegations relating to the valuation of the mortgage-related holdings, the court held that there was "no single, objectively acceptable method for valuing the complex asset-backed instruments at issue here" and that the complaint contained no allegation that defendants had failed to follow the valuation procedures outlined in the offering documents. Id. at 379-81.

After plaintiffs filed a motion requesting leave to amend, accompanied by an amended pleading, the court granted plaintiffs' motion and vacated the judgment for defendants. See Yu v. State Street Corp., No. 08 Civ. 8235, 08 MDL No. 1945, 2010 WL 2816259 (S.D.N.Y. July 14, 2010). The court found that the amended complaint cured plaintiffs' failure to plead materiality because "the well-pleaded allegations [in the amended complaint] are that defendants understated the mortgage-backed statistic—a statistic they found significant enough to include in the Annual Reports—by more than 100%. That misstatement is not so obviously unimportant as to warrant dismissal of claims premised thereon. Secondly, plaintiff now alleges that mortgage-related securities as a whole represented 87% of the Fund's portfolio at a time when the Annual Report stated that mortgage backed securities represented only 13.8% of the Fund. In light of this addition, the [amended complaint] states a plausible claim that the Annual Report materially misled investors by disclosing that a specific type of mortgage-related security represented only a small portion of the portfolio, while at the same time failing to disclose that the Fund invested nearly all of its assets in mortgage-related securities of some sort." Id. at *3. In light of other concerns raised by defendants with respect to the amended complaint, the court invited defendants to file a second motion to dismiss. Id. at *4.

Defendants did subsequently file another motion to dismiss, which was granted with prejudice on loss causation grounds. See infra; Yu v. State Street Corp., 774 F. Supp. 2d 584 (S.D.N.Y. 2011). Plaintiffs appealed Judge Holwell's loss causation ruling, but the case settled shortly thereafter. See Yu v. State Street Corp., No. 08-cv-8235, Order and Final Judgment (S.D.N.Y. Sept. 6, 2012). Following approval of the parties' settlement, on January 3, 2013, the parties stipulated to withdraw the appeal, and on January 28, 2013, that stipulation was entered as an order. See Yu v. State Street Corp., No. 11-1908 (2d Cir. Jan 28. 2013).

i. In In re Evergreen Ultra Short Opportunities Fund Securities Litigation, 705 F. Supp. 2d 86 (D. Mass. 2010), mutual fund investors brought claims alleging violations of Sections 11, 12(a)(2), and 15 of the 1933 Act, stemming from plaintiffs' investment in mutual funds that had exposure to residential mortgage-backed securities and other "risky" assets. Plaintiffs claimed that investments in such securities were not proper for a fund that was marketed to investors "as a higher-yielding alternative to money market funds, offering a combination of safety and liquidity." Id. at 89. Defendants moved to dismiss plaintiffs' claims on the grounds that plaintiffs failed to identify any material misrepresentations or omissions. Judge Gorton disagreed and held that plaintiffs had identified three such statements.

First, the court found that plaintiffs had adequately alleged that the fund's investment objectives were materially misleading. Defendants claimed that the investment objectives were "merely aspirational and do not promise that specific results will be achieved." The court disagreed noting that the "the basic claim that the Fund sought to 'provide income consistent with preservation of capital and low principal fluctuation,' . . . was surrounded by other more specific statements regarding the Fund's objectives [that] made distinct claims about the posture of the Fund, its investment strategies, and the rules under which it would operate. Such statements were not so 'general and indefinite' as to be devoid of any meaning, but were, in all likelihood, of utmost importance to potential investors." Id. at 92.

Further, the court found that defendants' statements were not protected by the "bespeaks caution doctrine" because: (1) statements as to a fund's "ground rules" cannot be classified as "forecasts, estimates, opinions, or projections"; and (2) generic warnings "in the prospectuses . . . that the Fund is not guaranteed to meet its goals did not disclose the risky nature of the Fund's investments with sufficient clarity . . . nor did it expressly warn of the particular risk that allegedly brought about plaintiffs' loss." Id. at 93 (citations omitted).

Second, the court found that plaintiffs had adequately alleged that defendants had issued misleading statements about the percentage of illiquid securities the fund was allowed to hold. In doing so, Judge Gorton cited "plaintiffs' detailed allegations concerning the inherent illiquidity of [certain securities]. . . ." Further, the court noted that "to the extent that there is a factual dispute concerning whether [those] securities were illiquid," resolution of that dispute was not proper on a motion to dismiss. Id.

Finally, the court found that statements comparing the fund and certain indices were materially misleading because plaintiffs had adequately alleged that the fund had a longer portfolio duration than the cited indices. See id. at 94 (citing In re Charles Schwab Corp. Sec. Litig., 257 F.R.D. 534, 543 (N.D. Cal. 2009)).

On August 10, 2011, Judge Gorton granted plaintiffs' motion for class certification. See In re Evergreen Ultra Short Opportunities Fund Secs. Litig., No. 08-CV-11064, 2011 WL 3567830 (D. Mass. Aug. 10, 2011).

On June 29, 2012, the parties settled the action for $25 million. On December 18, 2012, the court approved the settlement and dismissed the case with prejudice. See In re Evergreen Ultra Short Opportunities Fund Secs. Litig., No. 08-CV-11064 (D. Mass. Dec. 18, 2012).

j. In In re Charles Schwab Corp. Securities Litigation, No. C 08-1510, 2010 WL 1463490 (N.D. Cal. Apr. 8, 2010), mutual fund investors brought an action based on Sections 11, 12(a)(2), and 15 of the 1933 Act, as well as state law, against defendants, who included the mutual fund investment adviser, its affiliated entities and officers, and the mutual fund's independent trustees. Plaintiffs alleged that defendants misrepresented the risk profile and assets of the fund at issue, and improperly changed the fund's investment policies. Specifically, plaintiffs alleged that while the fund had "represented that it was diversified and that its plan was never to concentrate more than 25 percent in a single industry," defendants improperly changed the fund's investment policies to allow it to invest heavily in mortgage backed securities. Id. at *1, 3.

In response, defendants argued that they had put investors on notice of the change in investment policy by virtue of the inclusion of three sentences in an SAI that stated that the "fund may invest more than 25% of its total assets in privately-issued mortgage-backed securities . . . ." Id. (citation omitted). The court found, however, that "a jury could reasonably find that the three sentences had a low profile compared to the much higher profile to the attractive features of the fund, that the three sentences were not cross-referenced in places one might have expected them to be cross-referenced in the interests of plain disclosure, and that the now-claimed message of the three plain sentences was at war with the selling points for the fund, . . . and, overall, that a reasonable investor taking ordinary care to read the entire registration statement would not have been fairly advised, in the total mix of the information, that Schwab felt free to invest more than 25 percent . . . of the fund in uninsured mortgage-backed securities."

Id. at *4. Finally, Judge Alsup distinguished Yu v. State Street Corp., No. 08 Civ. 8235, 2010 WL 668645 (S.D.N.Y. Feb. 25, 2010), on the grounds that Yu contained different disclosures and that in that case "[t]here was no attempt to define away the problem . . . ." In re Charles Schwab, 2010 WL 1463490, at *6.

Subsequent to the court's denial of defendants' motion, the parties settled plaintiffs' federal and state claims for $200 million and $35 million, respectively.

k. In In re Oppenheimer Rochester Funds Group Securities Litigation, 838 F. Supp. 2d 1148 (D. Colo. 2012), investors in seven Oppenheimer municipal bond funds brought suit under Sections 11, 12 and 15 of the 1933 Act. Plaintiffs alleged that while the funds were marketed as "stable income-seeking investments that also focused on the preservation of investors' capital," the funds in reality invested in illiquid bonds or highly-leveraged derivatives. Plaintiffs contended that the funds' disclosures "were materially misleading and rendered investors' capital extremely vulnerable to changing market conditions. When the credit crisis of 2008 struck, Defendants' undisclosed high-risk strategies resulted in an extreme devaluation of the Funds' assets . . . ." Id. at 1152.

In denying defendants' motion to dismiss, the court first rejected defendants' argument that the fund's objective of "preservation of capital" was merely an "aspirational expression of an investment goal that cannot . . . be construed as an untrue statement of material fact." Id. at 1160. The court ruled that the phrase "preservation of capital has a set meaning that an investor's principal will be protected from erosion or loss." Id. Since plaintiffs alleged that defendants' disclosures failed to alert them that their investments "would indeed be eroded or lost if prevailing market conditions changed, a statement that the Funds would be managed—even if also 'aggressively,' as Defendants insist Plaintiffs knew—in a manner that was ultimately 'consistent with the preservation of capital' would be important to the overall mix of information available to a reasonable investor." Id. at 1160-61.

The court also found that plaintiffs had stated a claim with regard to the funds' investment in highly-leveraged derivatives known as "inverse floaters." The court found that defendants' warnings regarding inverse floater volatility risk were not sufficiently substantive, tailored, and prominent as "to negate any plausible inference that they were misleading or rendered other Prospectus statements materially so." Id. at 1167. Likewise, the court found that defendants' remaining disclosures regarding the risks of

inverse floaters (i.e., the possibility of trust collapses and forced sales), and the funds' limits on investing in them, to be misleading as well. Id. at 1167-70.

Next, the court found defendants' disclosures that the funds would not invest more than 15% of their assets in illiquid securities to be materially misleading. While defendants argued that plaintiffs' claims failed because "liquidity determinations are subjective judgments" that are not actionable under the 1933 Act, the court found that if "a security's designation as liquid or illiquid is purely subjective and solely within the business judgment of Defendants to determine, then the statements conveyed no meaningful information, and certainly no meaningful assurances, to prospective investors. Yet the statements clearly suggest something real is being warranted: Each Prospectus defined 'illiquidity' in concrete terms and assured investors that liquidity would be 'monitored' on an 'ongoing basis' and maintained at less than 15%. If Defendants' position is accepted, the statements communicated nothing substantive to potential investors and for that reason alone were plausibly misleading." Id. at 1171.

Finally, the court sustained plaintiffs' claim that defendants misled investors by disclosing that they would value the fund by relying on "observable" inputs. Plaintiffs claimed that defendants instead relied largely on subjective marks that overstated the funds' values. "As a result, when Funds ultimately sold assets, investors were forced to accept the actual 'fair value' the market would pay, which was less than the 'value' Defendants had assigned using their undisclosed, subjective internal valuation techniques." Id. at 1172. Defendants argued that since municipal securities are not publicly traded, the funds abided by their duties in following their disclosed procedures for valuing non-trading securities. The court rejected this argument, however, and noted that defendants' disclosures "repeatedly reference 'actual' sales and comparisons to 'actual' sale prices, and clearly suggest portfolio holdings, which were comprised 'mainly' of municipal securities, would be valued consistent with available external information." Id. at 1174.

On March 12, 2014, the court offered its preliminary approval of a settlement between the parties. A settlement hearing is scheduled for July 31, 2014.

3. Loss Causation

a. In In re Salomon Smith Barney Mutual Fund Fees Litigation, 441 F. Supp. 2d 579 (S.D.N.Y. 2006), plaintiffs alleged that Salomon Smith Barney ("SSB") and certain affiliated entities engaged in a

scheme that consisted of: (1) SSB offering undisclosed incentives to brokers and financial advisors to steer investors into SSB's proprietary funds and other funds with which SSB had undisclosed "kickback" arrangements; (2) SSB extracting improper fees from investors in its proprietary funds; and (3) SSB causing its proprietary funds to invest in poorly performing companies because of their status as SSB investment banking clients. See id. at 583-85. Plaintiffs claimed that this purported scheme constituted violations of, inter alia, Sections 11, 12(a)(2), and 15 of the 1933 Act.

Defendants moved to dismiss the 1933 Act claims arguing, inter alia, that the complaint failed to plead loss causation. The court agreed, finding that "[i]t is long settled that a securities-fraud plaintiff must prove both transaction and loss causation," id. at 588 (citation and quotation omitted), and noting that plaintiffs failed to allege why they lost money on their investment and why the loss was "for the precise reason complained of. . . ." Id. at 591. Although the court held that plaintiffs pleaded transaction causation by alleging that but for the complained-of practices plaintiffs would not have purchased shares of the fund, the court held that plaintiffs failed to establish loss causation with respect to their allegations of improper fees because: (1) plaintiffs' claims fall outside of the federal securities scheme absent a link between such fees and the funds' decline; and (2) where defendants "disclosed the total fees . . . , allocation of fees would not affect mutual fund share value." See id. at 589-90 (citing Castillo v. Dean Witter Discover & Co., No. 97 Civ. 1272, 1998 WL 342050, at *4-6 (S.D.N.Y. June 25, 1998)).

b. In In re Charles Schwab Corp. Securities Litigation, 257 F.R.D. 534 (N.D. Cal. 2009), mutual fund investors brought an action based on Sections 11, 12(a)(2) and 15 of the 1933 Act, as well as state law, against defendants, who included the mutual fund investment adviser, its affiliated entities and officers, and the mutual fund's independent trustees. Plaintiffs alleged that defendants misrepresented the risk profile and assets of the fund at issue, and improperly changed the fund's investment policies. Id. at 542. In denying defendants' motion to dismiss, Judge Alsup rejected defendants' argument that plaintiffs could not establish loss causation because the alleged misrepresentations did not affect the fund's net asset value. Id. at 546-48. The court held that "[t]he concept of loss causation is analogous to the common-law doctrine of proximate cause," and, as such, is satisfied "where a plaintiff proves that it was the very facts about which the defendant lied which caused its injuries." Id. at 547 (citations omitted). Therefore, the court found that it was sufficient that plaintiffs

alleged that "the *subject* of the fraudulent statements caused their losses – that defendants misrepresented or failed to disclose portfolio risks, the materialization of which caused (or exacerbated) the losses." Id. (emphasis in original).

On April 8, 2010, Judge Alsup denied defendants' motion for summary judgment regarding loss causation. See In re Charles Schwab Sec. Litig., No. C 08-1510, 2010 WL 1463490 (N.D. Cal. Apr. 8, 2010). Specifically, the court reasoned that "if a mutual fund holds itself out as investing in no more than 25 percent in a single industry but then, as actually planned, invests fifty percent in a single industry, there is no escape by blaming the industry rather than the promoter. The materialization of the concealed risk causes the loss." Id. at *6 (citation omitted).

Subsequent to the court's denial of defendants' motion for summary judgment, the parties settled plaintiffs' federal and state claims for $200 million and $35 million, respectively.

c. In Gosselin v. First Trust Advisors, L.P., No. 08 C 5213, 2009 WL 5064295 (N.D. Ill. Dec. 17, 2009), mutual fund investors brought claims alleging violations of Sections 11, 12(a)(2), and 15 of the 1933 Act; and Sections 10(b), 14(a), and 20(a) of the 1934 Act, stemming from plaintiffs' investment in mutual funds that had exposure to residential mortgage-backed securities and other "risky" assets. With regard to plaintiffs' claims under the 1933 Act, Judge Der-Yeghiayan noted that while such claims "do not require that proof of loss causation be pled as an element of the claim . . . [a] showing of negative causation can be asserted as an affirmative defense. . . ." Id. at *7. However, since plaintiffs' complaint did "not suggest such negative causation," Judge Der-Yeghiayan stated that "Defendants will therefore have to rely on a negative causation argument, if appropriate, at a later stage in the litigation." Id.

d. In In re Evergreen Ultra Short Opportunities Fund Securities Litigation, 705 F. Supp. 2d 86 (D. Mass. 2010), mutual fund investors brought claims alleging violations of Sections 11, 12(a)(2), and 15 of the 1933 Act, stemming from plaintiffs' investment in mutual funds that had exposure to residential mortgage-backed securities and other "risky" assets. Plaintiffs claimed that investments in such securities were not proper for a fund that was marketed to investors "as a higher-yielding alternative to money market funds, offering a combination of safety and liquidity." Id. at 89.

Defendants moved to dismiss plaintiffs' claims on the grounds that plaintiffs could not establish loss causation. While the court noted that loss causation is not an element of a claim under Sections 11 and 12, the court concluded that "occasionally courts have dismissed claims under Sections 11 and 12 on the pleadings when it was apparent on the face of the complaint that the plaintiffs would be unable to establish loss causation." Id. at 94 (quotation omitted). The court declined to dismiss plaintiffs' claims, however, because the complaint alleged that "defendants made false representations about the riskiness of the Fund's investments and artificially inflated the NAV throughout the Class Period. When the defendants' alleged misstatements were ultimately revealed, the NAV declined in value, resulting in losses to the Fund. Those allegations are sufficient . . . to survive a motion to dismiss." Id. at 95. In so holding, the court rejected defendants' argument that since "the NAV is bound, by statute, to the Fund's assets, its decline resulted from the depreciation and re-valuation of those assets, rather than from any misrepresentations or omissions. . . ." Id. at 94-95 (citing In re Charles Schwab Corp. Sec. Litig., 257 F.R.D. 534, 547 (N.D. Cal. 2009)).

On August 10, 2011, Judge Gorton granted plaintiffs' motion for class certification. See In re Evergreen Ultra Short Opportunities Fund Secs. Litig., No. 08-CV-11064, 2011 WL 3567830 (D. Mass. Aug. 10, 2011).

On June 29, 2012, the parties settled the action for $25 million. On December 18, 2012, the court approved the settlement and dismissed the case with prejudice. See In re Evergreen Ultra Short Opportunities Fund Secs. Litig., No. 08-CV-11064 (D. Mass. Dec. 18, 2012).

e. In In re Regions Morgan Keegan Securities, Derivative & ERISA Litigation, 743 F. Supp. 2d 744 (W.D. Tenn. 2010), investors in several Regions Morgan Keegan mutual funds filed suit against the funds' investment adviser, its affiliate, its auditor, and several adviser executives and fund independent trustees alleging violations of Sections 11, 12, and 15 of the 1933 Act, Sections 10 and 20 and Rule 10b-5 of the 1934 Act, and Sections 11, 22, 34, and 47 of the 1940 Act. Specifically, plaintiffs alleged that defendants violated the funds' investment policies through heavily investing in CDOs, which eventually led to the funds' demise. Id. at 752. With regard to plaintiffs' 1933 Act claims, defendants argued that plaintiffs' Section 11 claim was deficient for failure to plead loss causation. After noting that several courts have allowed Section 11 claims to proceed based on similar facts, the court stated that "[l]oss causation is not an element of a § 11 claim; it is

an affirmative defense unsuitable for adjudication in a motion to dismiss." Id. at 760 (citations omitted). The court subsequently denied defendants' motion for reconsideration. See In re Regions Morgan Keegan Sec., Deriv. & ERISA Litig., No. 07-2784, MDL 2009, 2010 WL 5464792, at *5 (W.D. Tenn. Dec. 30, 2010).

f. In Rafton v. Rydex Series Funds, No. 10 CV 01171, 2011 WL 31114 (N.D. Cal. Jan. 5, 2011), plaintiffs filed a putative class action asserting claims under Sections 11, 12(a)(2) and 15 of the 1933 Act. Plaintiffs, investors in the Rydex Inverse Government Long Bond Strategy Fund, alleged that the fund's offering documents were materially misleading "by misrepresenting who was an appropriate investor in the Fund [i.e., daily vs. long-term] and by failing to adequately disclose a 'mathematical compounding effect' that would cause the Fund to deviate from its benchmark, the inverse price of the 30-Year U.S. Treasury Bond." Id. at *1. With regard to loss causation, the court first noted that while loss causation is not an element of a 1933 Act claim, that courts have dismissed claims at the motion to dismiss stage when a lack of loss causation is apparent. Id. at *10. While defendants argued that plaintiffs could never show loss causation because the manner in which mutual funds are priced makes it impossible for a fund's disclosures to effect the fund's price, the court noted that this "argument has recently been rejected by another judge in this District, and for good reason." Id. at *11 (citing In re Charles Schwab Corp. Secs. Litig., 257 F.R.D. 534, 547 (N.D. Cal. 2009)). Indeed, the court noted that defendants' argument "would lead to the absurd result that such funds could even *intentionally* misrepresent material facts with impunity." Rafton, 2011 WL 31114, at *11 (emphasis in original). The court thus sustained plaintiffs' complaint after noting that "Plaintiffs allege that their loss in this case was caused, or exacerbated by, the 'materialization' of the concealed/undisclosed risk that holding the Fund for longer than one day would inevitably lead to a failure of the Fund to track the inverse performance of the 30-year U.S. Treasury Bond." Id. This case later settled. See Rafton v. Rydex Series Funds, No. 10 CV 01171, Final Judgment and Order of Dismissal (N.D. Cal. Feb. 10, 2012).

g. In Yu v. State Street Corp., 774 F. Supp. 2d 584 (S.D.N.Y. 2011), Judge Holwell dismissed a putative class action asserting claims under Sections 11, 12(a)(2) and 15 of the 1933 Act. Plaintiff, an investor in the Yield Plus Fund, alleged that the fund's offering documents were materially misleading because they "misrepresented the description and/or objectives of the Fund and misrepresented the Fund's exposure to risky mortgage-related assets and the risk of investing in the Fund." Id. at 585 (citation

omitted). With regard to loss causation, Judge Holwell first noted that while plaintiffs alleging Section 11 and 12(a)(2) claims need not allege loss causation, courts may dismiss complaints "if a defendant can prove that it is apparent on the face of the complaint that the alleged loss is not causally connected to the misrepresentations at issue." Id. at 588 (citation omitted).

Reviving the loss causation debate recently discussed in Rafton v. Rydex Series Funds, Defendants argued that plaintiff could not plead loss causation, as the fund's "NAV was not artificially inflated by anything State Street said in its prospectus—it accurately reflected the value of the investments it held any given time. Therefore, no 'materialization of the risk' hidden by the prospectus could cause a decline in the NAV, since the NAV was never inflated by statements in the prospectus." Id. at 591. Plaintiff responded by citing a number of cases, including Rafton, which recognized that defendants' argument would "effectively insulate mutual fund companies from claims for a wide range of material misrepresentations regarding fund policies, risks and investment decisions." Id. at 591-92 (quoting In re Charles Schwab Corp. Secs. Litig., 257 F.R.D. 534, 547 (N.D. Cal. 2009)) (also citing In re Evergreen Ultra Short Opportunities Fund Secs. Litig., 705 F. Supp. 2d 86 (D. Mass. 2010); Rafton v. Rydex Series Funds, No. 10 CV 01171, 2011 WL 31114 (N.D. Cal. Jan. 5, 2011)).

Judge Holwell rejected plaintiff's argument, however, on the basis that defendants' argument was technically correct. Indeed, Judge Holwell noted that the 1933 Act "restricts damages to those depreciations in the NAV that actually *result from* the materialization of a risk contained within a material misstatement, not to those that are somehow connected with the misstatement or even those that are simply 'within the zone of risk' of the misstatement." Yu, 774 F. Supp. 2d at 595 (emphasis in original) (also citing In re Morgan Stanley Mutual Fund Secs. Litig., No. 03 Civ. 8208, 2006 WL 1008138 (S.D.N.Y. Apr. 18, 2006); In re Salomon Smith Barney Mutual Fund Fees Litig., 441 F. Supp. 2d 579 (S.D.N.Y. 2006)). While Judge Holwell recognized that his textual analysis would make it difficult to allege 1933 Act claims against the mutual fund industry, he responded by noting: (1) plaintiff likely should have brought suit under Section 10(b) of the 1934 Act, which has a much broader scope than Sections 11 and 12 under the 1933 Act; and (2) Congress is free to close the "loophole" that the 1933 Act seems to create for mutual fund managers. Yu, 774 F. Supp. 2d at 595. Plaintiffs appealed Judge Holwell's loss causation ruling, but the case settled shortly thereafter. See Yu v. State Street Corp., No. 08-cv-8235, Order

and Final Judgment (S.D.N.Y. Sept. 6, 2012). Following approval of the parties' settlement, on January 3, 2013, the parties stipulated to withdraw the appeal, and on January 28, 2013, that stipulation was entered as an order. See Yu v. State Street Corp., No. 11-1908 (2d Cir. Jan 28. 2013).

h. In In re Oppenheimer Rochester Funds Group Securities Litigation, 838 F. Supp. 2d 1148 (D. Colo. 2012), investors in seven Oppenheimer municipal bond funds brought suit under Sections 11, 12 and 15 of the 1933 Act. Plaintiffs alleged that while the funds were marketed as "stable income-seeking investments that also focused on the preservation of investors' capital," the funds in reality invested in illiquid bonds or highly-leveraged derivatives. Plaintiffs contended that the funds' disclosures "were materially misleading and rendered investors' capital extremely vulnerable to changing market conditions. When the credit crisis of 2008 struck, Defendants' undisclosed high-risk strategies resulted in an extreme devaluation of the Funds' assets . . . ." Id. at 1152.

With regard to loss causation, the court first noted that while loss causation is not an element of a 1933 Act claim, that courts have dismissed claims at the motion to dismiss stage when a lack of loss causation is apparent. Id. at 1174. Citing Yu v. State Street Bank & Trust Co., 774 F. Supp. 2d 584 (S.D.N.Y. 2011), defendants argued that plaintiffs could never show loss causation because the manner in which mutual funds are priced makes it impossible for a fund's disclosures to effect the fund's price. See Oppenheimer, 838 F. Supp. 2d at 1175. The court rejected this argument, however, and criticized it as "sweepingly broad." Id. The court thus sustained plaintiffs' complaint after noting that it was "premised on allegations that misstatements and omissions in Fund Prospectuses concealed the price-volatility and risk associated with aggressive and highly leveraged investment strategies that resulted in an exponential devaluation of Fund assets and collateralization in times of rising interest rates." Id.

On March 12, 2014, the court offered its preliminary approval of a settlement between the parties. A settlement hearing is scheduled for July 31, 2014.

i. In In re Direxion Shares ETF Trust, 279 F.R.D. 221 (S.D.N.Y. 2012), investors in several funds that sought a daily investment return of three times the inverse of a certain index brought suit against the funds' investment adviser, its affiliate, and the funds' independent trustees alleging violations of Sections 11 and 15 of the 1933 Act. Specifically, plaintiffs alleged that defendants'

initial disclosures "did not disclose that holding shares in the Funds for longer than a single day could result in significant loss." Id. at 226. With regard to loss causation, defendants cited Yu v. State Street Corp., 774 F. Supp. 2d 584 (S.D.N.Y. 2011) for the proposition that defendants' disclosures could not have effected a change in the funds' price. In re Direxion, 279 F.R.D. at 233. The court noted, however, that the Yu decision was premised, in part, on the fact that because "there is no secondary market for a mutual fund's shares, statements by a fund's issuer have no ability to 'inflate' the price of the fund's shares." Id. (quoting Yu, 774 F. Supp. 2d at 595). The court then rejected defendants' argument because it was undisputed that the ETFs in question were "sold on the secondary market." In re Direxion, 774 F. Supp. 2d at 233. The court later approved a class action settlement of $8 million.

4. Miscellaneous

a. In Siemers v. Wells Fargo & Co., No. C 05-4518, 2006 WL 2355411 (N.D. Cal. Aug. 14, 2006), plaintiff asserted numerous claims relating to Wells Fargo's revenue sharing program. According to plaintiff, Wells Fargo and certain related defendants engaged in a purportedly undisclosed "scheme" to pay unaffiliated third party broker-dealers in an effort to induce their customers into purchasing Wells Fargo-branded mutual funds. Plaintiff alleged that he was harmed by: (1) receiving biased advice from broker-dealers; and (2) the dissipation of fund assets by paying purportedly "excessive" fees to the investment adviser and distributor defendants. Plaintiff claimed that these "kickback" arrangements and Wells Fargo's failure to disclose them constituted violations of Sections 12 and 15 of the 1933 Act; Sections 10(b) and 20(a) of the 1934 Act; and Sections 36(b) and 48(a) of the Act. With respect to plaintiff's 1933 Act claims, defendants sought dismissal based, in part, on the fact that they were not "sellers" as required by Section 12. The court disagreed, noting that "[g]iven the robust allegations of steering recommendations by the broker defendants, they would ordinarily and easily be classified as 'sellers' within" the meaning of the Act. See id. at *19 (citing Pinter v. Dahl, 486 U.S. 622 (1988)).

b. In In re American Funds Securities Litigation, 556 F. Supp. 2d 1100 (C.D. Cal. 2008), Judge Feess dismissed plaintiffs' action alleging violations of various provisions of the 1933 Act and the 1934 Act on statute of limitations grounds. Plaintiffs' action, which was filed in December of 2006, alleged that defendants paid kickbacks to brokers to steer investors into purchasing defendants' mutual funds. With respect to the claims arising under the 1933 Act, Judge Feess found that plaintiffs were on inquiry notice for

purposes of the statute of limitations by February 2005, when the NASD fined and censured defendants for the exact conduct at issue in the litigation. Id. at 1104. Because the complaint was filed more than one year after plaintiffs had been placed on inquiry notice, the court dismissed plaintiffs' claims under the 1933 Act. Id. at 1105. Although the action continued on other grounds, on January 18, 2013, the court entered an order dismissing the action following plaintiffs' voluntary dismissal. In re Am. Funds Secs. Litig., No. 2:06-cv-7815 (C.D. Cal. Jan. 18, 2013).

c. In In re Charles Schwab Corp. Securities Litigation, 257 F.R.D. 534 (N.D. Cal. 2009), mutual fund investors brought an action based on Sections 11, 12(a)(2) and 15 of the 1933 Act, as well as state law, against defendants, who included the mutual fund investment adviser, its affiliated entities and officers, and the mutual fund's independent trustees. Plaintiffs alleged that defendants misrepresented the risk profile and assets of the fund at issue, and improperly changed the fund's investment policies. Id. at 542. In denying defendants' motion to dismiss, Judge Alsup rejected defendants' claims that they were not statutory "sellers" for the purposes of Section 12(a)(2). Id. at 549-50, 555. Starting with plaintiffs' general averments regarding defendants' solicitation activity, the court reasoned that since all defendants – including the independent trustees – signed registration statements, which "is at least suggestive of solicitation activity," plaintiffs had pleaded sufficient facts to survive a motion to dismiss. Id.

Judge Alsup also held that plaintiffs stated a claim for control-person liability under Section 15 against all defendants including the independent trustees. With regard to the individual officers and the independent trustees, Judge Alsup reasoned that because these defendants had "signed the registration statements at issue," they were "in a position to control" the disputed statements. Id. at 550-51, 555.

On April 8, 2010, Judge Alsup denied defendants' motions for summary judgment regarding plaintiffs' Section 12 claims. See In re Charles Schwab Corp. Sec. Litig., No. C 08-1510, 2010 WL 1445445 (N.D. Cal. Apr. 8, 2010). First, the independent trustees argued that they were entitled to summary judgment because the record proved "that they did not solicit the purchase of the fund's shares." Id. at *5. The court rejected this argument, however, finding that the "record shows that the independent trustees maintained direct oversight of the fund's management through various committees." Id. Specifically, the court found that there was evidence that the independent trustees "participated in the marketing efforts of the fund by serving [on a marketing and

distribution committee]" and by reviewing and providing input regarding advertising strategies. Id. at *6.

The court likewise rejected a motion for summary judgment filed by the chief investment officer of the adviser. The court noted that there was an issue of fact as to whether the officer was a "seller" under Section 12 since the record demonstrated that the officer engaged in "more than 40 appearances . . . before investors and financial media where he promoted Schwab and its funds, including [the fund at issue]." Id. at *7. The court also noted how the officer had communicated with investors regarding "whether to hold the fund" and had previously referred to himself as a "tireless marketer of the funds." Id. (citation omitted).

Subsequent to the court's denial of defendants' motions for summary judgment, the parties settled plaintiffs' federal and state claims for $200 million and $35 million, respectively.

d. In Gosselin v. First Trust Advisors, L.P., No. 08 C 5213, 2009 WL 5064295 (N.D. Ill. Dec. 17, 2009), mutual fund investors asserted violations of Sections 11, 12(a)(2), and 15 of the 1933 Act; and Sections 10(b), 14(a), and 20(a) of the 1934 Act, stemming from plaintiffs' investment in mutual funds that had exposure to residential mortgage-backed securities and other "risky" assets. Defendants moved to dismiss the action. In denying defendants' motion to dismiss, the court first discussed defendants' contention that "Plaintiffs merely contend that Defendants mismanaged the Funds and that [this warrants dismissal] because allegations of corporate mismanagement are not actionable under federal securities laws." Id. at *2. Finding that in addition to claims of poor business judgment "Plaintiffs also contend that Defendants engaged in deception through material misrepresentations and omissions to conceal the ramifications of Defendants' alleged misconduct," the court concluded that plaintiffs had alleged actionable conduct under the federal securities laws. Id. at *2-3.

With regard to plaintiffs' Section 11 and 12(a)(2) claims, Judge Der-Yeghiayan rejected defendants' argument that plaintiffs' claims were time-barred. While defendants contended that "Plaintiffs were on inquiry notice that the Funds invested in mortgage-related securities and that the Funds were experiencing losses as early as August 2007," the court credited plaintiffs' allegations that defendants "concealed" the impact that "sub-prime mortgages" would have on the funds, and that as a result, plaintiffs did not become aware of their claims until July 2008 when a fund disclosure revealed a substantial decline in that fund's net asset value. Id. at *8. Judge Der-Yeghiayan also noted that "it is

generally not appropriate to resolve a statute of limitations issue at the pleadings stage. . . ." Id. at *9.

Defendants also sought to dismiss plaintiffs' Section 11 and 12(a)(2) claims on the grounds that plaintiffs knew of the alleged misrepresentations or omissions in the funds' disclosures when they purchased their shares. See 15 U.S.C. §§ 77k, 771(a)(2). Judge Der-Yeghiayan rejected this argument, however, citing plaintiffs' allegations that they "did not become aware of the misstatements or omissions until" after the purchases occurred. Gosselin, 2009 WL 5064295, at *9.

Finally, Judge Der-Yeghiayan declined to dismiss plaintiffs' control-person claims under Section 15. Judge Der-Yeghiayan based his decision on his earlier ruling that plaintiffs had pled a primary violation of the 1933 Act, and that plaintiffs had also alleged sufficient facts relating to certain defendants' "management positions, access to information, and ability to prevent [the] issuance of misleading statements. . . ." Id. at *10.

e. In In re Evergreen Ultra Short Opportunities Fund Securities Litigation, 705 F. Supp. 2d 86 (D. Mass. 2010), mutual fund investors brought claims alleging violations of Sections 11, 12(a)(2), and 15 of the 1933 Act, stemming from plaintiffs' investment in mutual funds that had exposure to residential mortgage-backed securities and other "risky" assets. Plaintiffs claimed that investments in such securities were not proper for a fund that was marketed to investors "as a higher-yielding alternative to money market funds, offering a combination of safety and liquidity." Id. at 89. The Trustee Defendants—twelve members of the Evergreen Board of Trustees—moved to dismiss plaintiffs' claims on the grounds that plaintiffs failed to allege that defendants were statutory sellers within the meaning of Section 12(a)(2). Id. at 95. The court granted the Trustee Defendants' motion because "plaintiffs allege only that the Trustee Defendants signed the registration statements and participated in the drafting, preparation and/or approval of the Offering Materials." Id. at 96. In the First Circuit, however, such allegations are insufficient to demonstrate a defendant's direct involvement in the actual sale of a security. See id. (citing Shaw v. Digital Equip. Corp., 82 F.3d 1194, 1215-16 (1st Cir. 1996)); but see In re Charles Schwab Corp. Sec. Litig., 257 F.R.D. 534, 549 (N.D. Cal. 2009) (coming to opposite conclusion).

But Judge Gorton declined to dismiss plaintiffs' claims under Section 15 of the 1933 Act. Finding that plaintiffs had alleged that the "Trustee Defendants did more than just sign the Trust's SEC

filing," the court found that "plaintiffs' allegations of control are sufficient to withstand the motion to dismiss." Id. at 97. Influential in the court's analysis were allegations that defendants "participated in the drafting, preparation, and/or approval" of the fund's disclosures, as well as allegations that the defendants had the power to, and in fact, did "control the contents of the Offering Materials." Id. (citations omitted).

On August 10, 2011, Judge Gorton granted plaintiffs' motion for class certification. See In re Evergreen Ultra Short Opportunities Fund Secs. Litig., No. 08-CV-11064, 2011 WL 3567830 (D. Mass. Aug. 10, 2011).

On June 29, 2012, the parties settled the action for $25 million. On December 18, 2012, the court approved the settlement and dismissed the case with prejudice. See In re Evergreen Ultra Short Opportunities Fund Secs. Litig., No. 08-CV-11064 (D. Mass. Dec. 18, 2012).

f. In In re Regions Morgan Keegan Securities, Derivative & ERISA Litigation, 743 F. Supp. 2d 744 (W.D. Tenn. 2010), investors in several Regions Morgan Keegan mutual funds filed suit against the funds' investment adviser, its affiliate, its auditor, and several adviser executives and fund independent trustees alleging violations of Sections 11, 12 and 15 of the 1933 Act, Sections 10, 20 and Rule 10b-5 of the 1934 Act, and Sections 11, 22, 34 and 47 of the 1940 Act. Specifically, plaintiffs alleged that defendants violated the funds' investment policies through heavily investing in CDOs, which eventually led to the funds' demise. Id. at 752. With regard to plaintiffs' 1933 Act claims, defendants argued that plaintiffs' Section 12 claim was deficient because defendants were not "statutory sellers." Id. at 760-61. The court rejected defendants' argument, however, on the grounds that "whether someone 'solicits' a purchase is a fact-bound inquiry unsuited for a Rule 12(b)(6) motion." Id.

The court also ruled that because plaintiffs "have stated primary claims under the '33 Act, they may also state a claim under § 15 for control person liability." Id. at 761. Similarly, the court declined to entertain defendants' factual arguments at the motion to dismiss stage. Id. Finally, the court did dismiss plaintiffs' "holder" claims because the "'33 Act limits claims to *purchasers*." Id. (emphasis in original).

Finally, it bears noting that in denying defendants' motion for reconsideration on plaintiffs' '33 Act claims, the court denied defendants' additional argument that plaintiffs' "claims allege

mismanagement of the Defendant Funds and therefore . . . may only be raised in a derivative action." See In re Regions Morgan Keegan Sec., Der. & ERISA Litig., No. 07-2784, MDL 2009, 2010 WL 5464792, at *4 (W.D. Tenn. Dec. 30, 2010). The court reasoned that an "allegation that a statement was false when made is actionable under the federal securities laws and does not state an invalid mismanagement or fraud-by-hindsight claim." Id. at *5 (citation omitted).

g. In Rafton v. Rydex Series Funds, No. 10 CV 01171, 2011 WL 31114 (N.D. Cal. Jan. 5, 2011), plaintiffs filed a putative class action asserting claims under Sections 11, 12(a)(2) and 15 of the 1933 Act. Plaintiffs, investors in the Rydex Inverse Government Long Bond Strategy Fund, alleged that the fund's offering documents were materially misleading "by misrepresenting who was an appropriate investor in the Fund [i.e., daily vs. long-term] and by failing to adequately disclose a 'mathematical compounding effect' that would cause the Fund to deviate from its benchmark, the inverse price of the 30-Year U.S. Treasury Bond." Id. at *1.

Defendants initially challenged plaintiffs' action as being time-barred. After noting that "the determination of inquiry notice is 'fact intensive' and is usually not appropriate at the pleading stage," the court denied defendants' motion to dismiss on the grounds that "it was not obvious from the disclosures . . . that a fund with a daily benchmark would be inappropriate . . . for periods longer than a day." Id. at *10. The court was also not persuaded by defendants' citation to three news articles that "did not discuss the specific Fund at issue here" and which plaintiffs claimed were not "'widely available.'" Id.

The court also sustained plaintiffs' Section 15 claim by noting that plaintiffs had pled underlying 1933 Act violations, and by concluding that it was "'plausible' that high level officers . . . who signed the Registration Statements were in a position to exercise control over the Fund and its disclosures." Id. at *12 (citation omitted).

Finally, while the court dismissed plaintiffs' claims regarding registration statements pursuant to which plaintiffs did not purchase shares, the court denied defendants' motion to dismiss relating to share classes plaintiffs did not own. Rather, the court concluded that plaintiffs' claims were sufficient because all share classes were issued pursuant to the same disclosures. Id. at *13. This case later settled. See Rafton v. Rydex Series Funds, No. 10

CV 01171, Final Judgment and Order of Dismissal (N.D. Cal. Feb. 10, 2012).

h. In In re Oppenheimer Rochester Funds Group Securities Litigation, 838 F. Supp. 2d 1148 (D. Colo. 2012), investors in seven Oppenheimer municipal bond funds brought suit under Sections 11, 12 and 15 of the 1933 Act. Plaintiffs alleged that while the funds were marketed as "stable income-seeking investments that also focused on the preservation of investors' capital," the funds in reality invested in illiquid bonds or highly-leveraged derivatives. Plaintiffs contended that the funds' disclosures "were materially misleading and rendered investors' capital extremely vulnerable to changing market conditions. When the credit crisis of 2008 struck, Defendants' undisclosed high-risk strategies resulted in an extreme devaluation of the Funds' assets . . . ." Id. at 1152.

Defendants challenged plaintiffs' action as being time-barred and sought to rely on news articles purportedly apprising investors of the funds' strategies. The court rejected this argument on the grounds that "it is inappropriate for resolution on a motion to dismiss. Even if Lead Plaintiffs had read the articles, and even if the articles had triggered inquiry notice, the articles cannot be said to have provided 'all' the facts required for a reasonably diligent investor to discover the materially misleading nature of Defendants' statements regarding preservation of capital, risk, and liquidity." Id. at 1178.

The court also rejected defendants' argument that the adviser and the funds did not qualify as statutory "sellers." "With regard to the Funds themselves, the argument is foreclosed as a matter of logic and by SEC Rule 159A, providing that issuers of securities are statutory sellers for purposes of § 12(a)(2)." Id. at 1179. The court then found that plaintiffs' allegations that the adviser "actively solicited the Fund[s'] shares through the Prospectus, advertising and other marketing efforts to serve [its] own financial interests and controlled a person who offered and sold" the funds were sufficient to withstand the motion to dismiss. Id. at 1179-80. Finally, defendants' motion to dismiss plaintiffs' section 15 claims were rejected as well. See id. at 1182.

On March 12, 2014, the court offered its preliminary approval of a settlement between the parties. A settlement hearing is scheduled for July 31, 2014.

i. In In re Direxion Shares ETF Trust, 279 F.R.D. 221 (S.D.N.Y. 2012), investors in several funds that sought a daily investment

return of three times the inverse of a certain index brought suit against the funds' investment adviser, its affiliate, and the funds' independent trustees alleging violations of Sections 11 and 15 of the 1933 Act. Specifically, plaintiffs alleged that defendants' initial disclosures "did not disclose that holding shares in the Funds for longer than a single day could result in significant loss." Id. at 226.

Although the court sustained plaintiffs' complaint, the court first granted defendants' motion to dismiss with respect to funds in which plaintiffs never owned shares. Id. at 230. The court also rejected a motion to intervene on behalf of a potential plaintiff that could have cured the standing defects because the intervenor's claim was time-barred. Id. at 236.

The court also held, however, that certain of the original plaintiffs timely filed their actions because: (1) the lead plaintiff's complaint was filed less than a year after the funds were issued to the public; and (2) certain other plaintiffs who may have discovered the alleged misstatements "out of time" were able to relate back to the lead plaintiff's complaint. Id. at 232. Although the court found that two other plaintiffs may have been time-barred, the court permitted plaintiffs to amend their statute of limitations allegations, and subsequently ruled that the two plaintiffs were not time-barred. In re Direxion Shares ETF Trust, No. 09 Civ. 8011, 2012 WL 717967 (S.D.N.Y. Mar. 6, 2012).

The court later approved a class action settlement of $8 million.

B. The Securities Exchange Act of 1934

1. Scienter

a. In Castillo v. Dean Witter Discover & Co., No. 97 Civ. 1272, 1998 WL 342050 (S.D.N.Y. June 25, 1998), plaintiffs alleged that defendants improperly influenced broker-dealers to promote their proprietary funds, that defendants failed to disclose their compensation policies, and that their funds had higher fees and performed worse than unaffiliated funds. Plaintiffs also alleged that defendants failed to adequately disclose the risks and fees of the proprietary funds.

Plaintiffs claimed defendants' conduct violated Section 10(b) of the 1934 Act. Defendants moved to dismiss the complaint in its entirety, arguing, inter alia, that plaintiffs failed to adequately plead scienter. The court agreed, noting that plaintiffs failed to allege facts demonstrating that defendants had either a motive and

opportunity to commit the fraud, or that there was strong circumstantial evidence of defendants' conscious misbehavior or recklessness. See id. at *10. Specifically, the court held that cursory allegations of a desire to increase the amount of assets under management as a means of increasing fees were too generalized a motive to constitute scienter. Rather, the court found that such allegations should be tied to individual brokers and the increased compensation they stood to earn on each sale. See id.

The court also held that plaintiffs' allegations failed to demonstrate strong circumstantial evidence of conscious misbehavior or recklessness. While plaintiffs cited media reports critical of defendants' policies, as well as another decision opining that Dean Witter should have disclosed that its brokers received greater compensation for recommending proprietary securities, the court found scienter to be lacking because defendants had disclosed all that it was required to disclose. See id. at *11.

b. In In re Morgan Stanley & Van Kampen Mutual Fund Securities Litigation, No. 03 Civ. 8208, 2006 WL 1008138 (S.D.N.Y. Apr. 18, 2006), plaintiffs brought a myriad of claims relating to Morgan Stanley's revenue sharing program. According to plaintiffs, Morgan Stanley provided incentives to its sales force of registered representatives to promote the sales of its proprietary funds. Plaintiffs claimed these sales incentives and Morgan Stanley's failure to disclose them constituted violations of Sections 11, 12 and 15 of the 1933 Act; Sections 10(b) and 20(a) of the 1934 Act; Sections 34(b), 36(b), and 48(a) of the Act; Sections 206 and 215 of the Investment Advisers Act of 1940; and state law. With respect to the 1934 Act, the court held plaintiffs' scienter allegations to be "inadequately pleaded under both the motive and opportunity and conscious misbehavior theories." Id. at *10 (citations omitted). The court was not persuaded by allegations that defendants concealed their fee allocations in order to increase the amount of money under their control, and noted that since "defendants complied with the SEC's disclosure requirements . . . defendants could not possess the required intent or recklessness." Id. at *10-11.

c. In Siemers v. Wells Fargo & Co., No. C 05-4518, 2006 WL 2355411 (N.D. Cal. Aug. 14, 2006), plaintiff asserted numerous claims relating to Wells Fargo's revenue sharing program. According to plaintiff, Wells Fargo and certain related defendants engaged in a purportedly undisclosed "scheme" to pay unaffiliated third party broker-dealers in an effort to induce their customers into purchasing Wells Fargo-branded mutual funds. Plaintiff alleged that he was harmed by: (1) receiving biased advice from

broker-dealers; and (2) the dissipation of fund assets by paying purportedly "excessive" fees to the investment adviser and distributor defendants. Plaintiff claimed that these "kickback" arrangements and Wells Fargo's failure to disclose them constituted violations of Sections 12 and 15 of the 1933 Act; Sections 10(b) and 20(a) of the 1934 Act; and Sections 36(b) and 48(a) of the Act. With respect to plaintiff's 1934 Act claims, the court first noted that in the Ninth Circuit, "scienter is properly alleged when the complaint alleges both false statements and the defendants' close involvement in the preparation of those statements." Id. at *8. Countering defendants' argument that they did not act with scienter because legal authority indicated revenue sharing was lawful at the time, the court found that if "defendants wish to rely on advice of counsel, that would be a matter for an affirmative defense. It cannot, however, destroy the inference of deliberate half truths alleged in the complaint." See id. at *9. The court then noted that since defendants were aware of the compensation agreements and believed that such agreements would increase sales of their proprietary funds, the "the failure to disclose the full extent of the payback programs raises a strong inference of scienter." See id.

Following the court's dismissal of plaintiff's Section 1934 Act claims on other grounds, plaintiff filed a third amended complaint. See Siemers v. Wells Fargo & Co., No. C 05-4518, 2007 WL 1140660 (N.D. Cal. Apr. 17, 2007). Again, defendants moved to dismiss plaintiff's claims for, inter alia, failing to properly allege scienter. And again the court denied the motion, finding that plaintiff had appropriately alleged that defendants "plainly *knew*" about the revenue sharing programs and held that defendants' disclosures were "buried" in unexpected places, thus creating "a strong inference of intentional misleading on a material investment consideration." See id. at *12 (emphasis in original).

d. In Garber v. Legg Mason, Inc., 537 F. Supp. 2d 597 (S.D.N.Y. 2008), Judge Chin dismissed investors' claims against Legg Mason and a number of its officers. Plaintiffs alleged violations of Sections 11, 12(a)(2) and 15 of the 1933 Act; and Sections 10(b) and 20(a) of the 1934 Act, stemming from purported misrepresentations made by defendants with respect to the share price of a secondary offering of Legg Mason common stock following its acquisition in an asset swap of substantially all of Citigroup's worldwide asset management division. Id. at 604-09. Specifically, plaintiffs alleged that the secondary offering's registration statement and announcements, made after the offering, omitted or misrepresented several matters concerning the integration of the newly-acquired Citigroup division into Legg

Mason's infrastructure. Id. at 607-08. In dismissing the complaint, Judge Chin held that plaintiffs failed to plead facts supporting "a strong inference of fraudulent intent," and further noted that plaintiffs "identif[ied] no internal reports of which defendants were aware and failed to disclose, and do not indicate specific data used by defendants in their fraud." Id. at 618. As a result, "Plaintiffs' generic, conclusory statement that fraudulent intent existed" was insufficient to meet the heightened pleading requirement under Federal Rule of Civil Procedure 9(b). Id. Judge Chin's decision was subsequently affirmed by the Second Circuit. See Garber v. Legg Mason, Inc., 347 F. App'x 665 (2d Cir. 2009).

e. In Hoffman v. UBS-AG, 591 F. Supp. 2d 522 (S.D.N.Y. 2008), investors in various UBS mutual funds brought a putative class action against, inter alia, UBS's affiliated broker-dealer, alleging violations of Sections 12(a)(2) and 15 of the 1933 Act; Sections 10(b) and 20(a) of the 1934 Act; and Section 36(b) of the Act. With respect to the 1933 Act and 1934 Act claims, plaintiffs alleged that the broker-dealer failed to disclose to investors that: (1) its internal compensation structure encouraged financial advisors to steer investors into purchasing certain UBS proprietary funds, as well as certain additional consulting services provided by UBS; and (2) that certain of the UBS advisors were incentivized to sell "Tier I" mutual funds because those fund families engaged in "revenue sharing" with the UBS broker-dealer entity. Id. at 527-28. Judge Sand granted defendants' motion to dismiss. After dismissing plaintiffs' claims under the 1933 Act, Judge Sand found that plaintiffs' claims under the 1934 Act also were insufficient, holding that alleging a "failure 'to disclose in a prospectus information that is neither material nor is required to be disclosed'" is insufficient to plead scienter. Id. at 536-37.

f. In In re Mutual Funds Investment Litigation (In re Janus and Putnam Subtracks), 590 F. Supp. 2d 741 (D. Md. 2008), mutual fund investors brought actions alleging violations of, inter alia, Section 10(b) of the 1934 Act, based on defendants' involvement in market timing schemes. In opposition to defendants' motion for summary judgment, plaintiffs claimed that the scienter element was satisfied because, even assuming that defendants acted in good faith in attempting to control market timing, defendants were still liable under Section 10(b) because they knowingly failed to disclose that some of the market timing activities were uncontrollable. Id. at 749. While noting that this theory was "sound in principle," Judge Motz held that it was a "substantial change" from the focus of the litigation up to this point, and that

allowing plaintiffs to argue the theory would substantially prejudice defendants. Id. at 750.[23] Thus, Judge Motz analyzed the sufficiency of plaintiffs' prior theory of scienter, namely, that the language in the prospectuses misled prospective purchasers of mutual fund shares into believing that defendants were attempting to stop market timing activities when, in fact, they were encouraging such activities either through express agreements or tacit understandings. Id. With respect to the Janus defendants, the court held that, while they had admitted engaging in arranged market timing, these defendants submitted proof that plaintiffs had already been fully compensated for these violations through Janus's regulatory settlement with the SEC and, as such, were entitled to summary judgment. Id. at 752. Judge Motz was unable to reach a decision with respect to whether the Janus defendants recklessly allowed market timing activities by broker-dealers, and ordered additional briefing to address that issue. Id. at 753.[24] With respect to the Putnam defendants, the court held that the Investor plaintiffs could not prove that defendants were complicit in the arranged or non-arranged market timing activities, and thus the Investor plaintiffs were unable to prove scienter. Id. at 753-58. Judge Motz did order additional briefing, however, as to whether the Putnam defendants had made full restitution with regard to market timing by Putnam employees in defined contribution and 401(k) accounts. Id. at 756.[25]

g. In In re Mutual Funds Investment Litigation (In re Janus and Putnam Subtracks), 626 F. Supp. 2d 530 (D. Md. 2009), mutual fund investors brought actions alleging violations of, inter alia, Section 10(b) of the 1934 Act based on defendants' involvement in market timing schemes. After previously requesting supplemental briefing as to the issue of the Janus defendants' scienter, see In re Mutual Funds Investment Litigation (In re Janus and Putnam Subtracks), 590 F. Supp. 2d 741, 753 (D. Md. 2008), Judge Motz

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[23] Plaintiffs subsequently filed motions for clarification or reconsideration as to whether they could assert this additional theory. Judge Motz denied these motions in their entirety. See In re Mutual Funds Inv. Litig. (In re Janus and Putnam Subtracks), 608 F. Supp. 2d 670, 670-71 (D. Md. 2009).

[24] Judge Motz subsequently granted summary judgment for the Janus defendants on this point. See infra at In re Mutual Funds Inv. Litig. (In re Janus and Putnam Subtracks), 626 F. Supp. 2d 530 (D. Md. 2009).

[25] Judge Motz subsequently found that defendants had, in fact, made such restitution. Accordingly, the court granted summary judgment for the Putnam defendants as to market timing in defined contribution and 401(k) plans. See In re Mutual Funds Inv. Litig. (In re Putnam Subtrack), 608 F. Supp. 2d 677, 679 (D. Md. 2009).

granted defendants' motion for summary judgment because "[w]hile Janus could have . . . done more to restrict the accounts it identified as market timers, a rational factfinder could not find that their actions amounted to intentional misconduct or recklessness. . . ." In re Mutual Funds, 626 F. Supp. 2d at 537. In particular, Judge Motz cited Janus's adoption of redemption fees, the viability of its detection methods, and "Janus's extensive efforts in warning and restricting accounts it identified as market timers" as evidence that Janus did not act with scienter. Id. at 533-36.

h. In Kreek v. Wells Fargo & Co., 652 F. Supp. 2d 1053 (N.D. Cal. 2009), mutual fund investors filed suit under Sections 10(b) and 20(a) of the 1934 Act claiming that defendants engaged in undisclosed revenue sharing arrangements. The action was a "sequel" to the "heavily litigated" Siemers v. Wills Fargo action. According to plaintiffs, defendants paid kickbacks to broker-dealers and selling agents to steer clients into defendants' funds, regardless of whether defendants' funds were the best option for investors. Plaintiffs claimed that the kickbacks were financed by hidden fees, the proceeds of which should have been invested in the funds' underlying portfolios. In denying defendants' motion to dismiss, Judge Alsup found that plaintiffs had pleaded scienter because "Wells Fargo and its key officers knew about its secret revenue-sharing program [and that] it was inadequately disclosed in the prospectuses." Id. at 1063. Specifically, Judge Alsup noted that the "way in which the secret program was buried in the prospectus indicates that defendants deliberately chose to hide it from the investors." Id.

i. In Gosselin v. First Trust Advisors, L.P., No. 08 C 5213, 2009 WL 5064295 (N.D. Ill. Dec. 17, 2009), mutual fund investors brought claims alleging violations of Sections 11, 12(a)(2), and 15 of the 1933 Act, and Sections 10(b), 14(a), and 20(a) of the 1934 Act, stemming from plaintiffs' investment in mutual funds that had exposure to residential mortgage-backed securities and other "risky" assets. With regard to plaintiffs' claims under Section 10(b), in denying defendants' motion to dismiss, Judge Der-Yeghiayan found that plaintiffs had pleaded a strong inference of scienter. Notably, Judge Der-Yeghiayan cited allegations that "Defendants had access to information contrary to the information contained in financial statements they distributed, that Defendants violated GAAP by ignoring market data and incorrectly valuing the Funds' NAV, and that Defendants' made false Sarbanes-Oxley certifications" as sufficient to form a strong inference that defendants acted with scienter. Id. at *6. The court also reasoned that defendants' argument that the motive put forth by plaintiffs

was economically irrational was "not an issue to be resolved at the pleadings stage." Id.

j. In Bachow v. Swank Energy Income Advisers, LP, No. 3:09-CV-262, 2010 WL 70520 (N.D. Tex. Jan. 6, 2010), an investor brought claims under Sections 10(b) and 20(a) of the 1934 Act; and Section 36(b) of the Act, against the fund's investment adviser, its affiliate, and several adviser executives and fund independent trustees. Plaintiff alleged that defendants misrepresented the fund's investment strategy and holdings, and that when "adverse information [regarding these topics] was disclosed to the public," the value of the fund's shares "plummeted." Id. at *1. In denying defendants' motion to dismiss the 1934 Act claims, the court found that plaintiff had pleaded scienter because the complaint alleged that: (1) adviser executives and fund independent trustees were aware that the illiquidity of fund assets, as well as the fund's history of poor performance, made it "extremely unlikely" that the fund would be able to adhere to its investment strategy; (2) the same individuals were aware of the fund's auditor's concerns regarding the valuation of the fund's net asset value ("NAV"), yet signed SEC filings which touted the fund's valuation policies; and (3) defendants were motivated to improperly value the fund's NAV so as to "maximize their own compensation." Id. at *6-7. In reaching its conclusion as to scienter, the court also credited plaintiff's allegation that the above-mentioned individual defendants had "authority to control whether relevant information about" the fund's investment strategy would be disclosed. Id.

k. In Zavolta v. Lord Abbett & Co. LLC, 2:08-cv-4546, 2010 WL 686546 (D.N.J. Feb. 24, 2010), an investor who purchased Class A shares of funds sponsored by Lord Abbett & Co. through her 401(k) retirement plan brought a suit against the funds' investment adviser and distributor for alleged violations of Section 10(b) of the 1934 Act. Specifically, plaintiff alleged that the public filings of the funds at issue misleadingly presented Class A shares as the "best-performing share class for the long-term." In fact, plaintiff claimed, because investors like plaintiff who purchased less than $50,000 of Class A shares were also subject to a 5.75% load, and because Class B shares automatically converted into Class A shares after eight years, it was irrational for an investor in plaintiff's position to purchase Class A shares. The alleged misrepresentations consisted of various tables that showed the fee expenses of the different classes of shares. See id. at *1. The court granted defendants' motion to dismiss based on plaintiffs' failure to plead scienter with adequate particularity. The court found that the allegedly misleading tables containing the various fee schedules failed to give rise to a strong inference of scienter

since the contents of those tables were consistent with the requirements of SEC Form N1-A and, in any event, plaintiff failed to allege that the individuals responsible for drafting or disseminating the offering documents were aware that certain investors would be better off not purchasing Class A shares. Id. at *12-13. The court similarly found that plaintiff's other allegations of scienter were similarly deficient. Id. at *13.

l. In Cascade Fund, LLP v. Absolute Capital Management Holdings Ltd., 707 F. Supp. 2d 1130 (D. Colo. 2010), individuals and entities that purchased mutual funds managed by defendants alleged that defendants made "misstatements and omissions of material facts in offering memoranda for mutual funds and hedge funds that lost a significant portion of their value when it was revealed that the value of the funds was based on inflated stock prices." Id. at 1134-35. Plaintiffs claimed defendants' conduct violated Section 10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder. The court granted defendants' motion to dismiss for failure to plead scienter because the "total lack of compelling and clear factual allegations concerning ACM's culpability leads the Court to conclude that Cascade has not satisfied the requirement to show a 'strong inference of scienter'. . . ." Id. at 1144.

m. In In re Regions Morgan Keegan Securities, Derivative & ERISA Litigation, 743 F. Supp. 2d 744 (W.D. Tenn. 2010), investors in several Regions Morgan Keegan mutual funds filed suit against the funds' investment adviser, its affiliate, its auditor, and several adviser executives and fund independent trustees alleging violations of Sections 11, 12, and 15 of the 1933 Act, Sections 10 and 20 and Rule 10b-5 of the 1934 Act, and Sections 11, 22, 34, and 47 of the 1940 Act. Specifically, plaintiffs alleged that defendants violated the funds' investment policies through heavily investing in CDOs, which eventually led to the funds' demise. Id. at 752. With regard to plaintiffs' 1934 Act claims, the court first noted that "[w]hen it is possible to ask legitimately, after reading a four-hundred-page Complaint, who is being sued for what on a particular count, Plaintiffs have not met the PSLRA's pleading standards." Id. at 755. The court also noted that even if it were to analyze the complaint with the assistance of the group pleading doctrine (the Sixth Circuit has not opined on whether the doctrine has survived the PSLRA), the complaint would still be deficient for failure to plead scienter. In particular, while plaintiffs alleged that defendants knew that the funds' liquidity disclosures were deficient because defendants issued, underwrote, or audited some of the same securities in which the funds invested, the court noted that plaintiffs undermined this allegation by failing to "identify the

securities by name and . . . not alleg[ing] how large a share of the Funds' assets they represented. Basing knowledge on two or twenty securities among differing investments made over a three-year period does not support a finding of scienter." Id. at 757-58. Further, the court noted that plaintiffs failed to allege sufficient detail regarding insider trading, and that plaintiffs' allegations regarding GAAP violations and self-interested motives of the defendants were "entitled to little or no weight." Id. at 759. The court subsequently denied plaintiffs' motion for reconsideration. See In re Regions Morgan Keegan Sec., Deriv. & ERISA Litig., No. 07-2784, MDL 2009, 2010 WL 5464792, at *2-4 (W.D. Tenn. Dec. 30, 2010).

n. In In re Mutual Funds Investment Litigation [Franklin Templeton Subtrack], 767 F. Supp. 2d 531 (D. Md. 2010), one of the many subsidiary proceedings in a multi-district litigation involving market timing, lead plaintiffs asserted that the Franklin Templeton defendants were liable under Rule 10b-5 because fund prospectuses indicated that Franklin Templeton "was taking steps to control market timing, yet failed to disclose that [Franklin Templeton] was intentionally or recklessly allowing such market timing to continue." Id. at 533. Defendants and plaintiffs moved for partial summary judgment on the claims brought under Rule 10b-5 as to non-arranged market timing. The court (Motz, J.) granted the defendants' motion and denied plaintiffs' motion.

The arguments centered on the issue of scienter. In connection with the motions, plaintiff had essentially split the class period into two sub-periods, and contended that: (1) defendants had done nothing to stop market timing during the first period, and thus plaintiffs should prevail on the issue of scienter during that period; and (2) defendants were not as aggressive as they could have been during the second period, and thus defendants' motion as to this period should be denied.

The court disagreed. As to the first period, the court held, and plaintiffs acknowledged, that defendants actively tracked and studied market timing in its funds. "[T]he 'monitor[ing],' 'review[ing],' and 'study[ing]' that Plaintiffs so harshly criticized actually constituted the first step in the process of stopping market timing activity," and thereafter market timing activity dropped in response to defendants' efforts. Id. at 534. The court concluded that even if plaintiff's argument that defendants should have been more aggressive in stopping marketing timing were true, "a defendant's 'failure to fact as aggressively as [it] could have, or should have, does not establish intentionality or recklessness." Id.

at 535 (quoting In re Mutual Funds Inv. Litig., 626 F. Supp. 2d 530, 534 (D. Md. 2009)).

As to the second period, plaintiff argued that "the record presents a factual issue as to whether [defendants'] efforts were made in good faith or were reckless in allowing market timing to continue." In re Mutual Funds Inv. Litig., 767 F. Supp. 2d at 535. The court found that defendants had taken numerous steps to combat market timing, including imposing redemptions fees; manually reviewing trades above a particular dollar threshold; issuing warnings to timers, terminating accounts, and rejecting trades; dedicating employees to combat market timing; eliminating or reducing bonuses and commissions arising from suspected market timing transactions; terminating dealer agreements; and working closely with external broker-dealer firms to combat market timing in omnibus accounts, all of which countered plaintiff's scienter arguments. "These efforts . . . clearly indicate a good faith commitment to controlling non-arranged market timing." Id. at 535-42.

o. In In re Smith Barney Fund Transfer Agent Litigation, 765 F. Supp. 2d 391 (S.D.N.Y. 2011), plaintiffs alleged that defendants, the investment adviser and two of its officers, recommended that certain Smith Barney funds retain the services of Citicorp Trust Bank ("CTB"), an affiliate of the funds' investment adviser, to serve as the primary transfer agent for the funds. Although CTB was responsible for providing all of the Smith Barney-branded mutual funds' transfer agent services, CTB allegedly subcontracted the vast majority of the transfer agent work to First Data Investor Services Group ("First Data"). Plaintiffs alleged that pursuant to this subcontract, First Data charged significantly lower fees, yet defendants did not pass on or disclose those discounts to the funds. Id. at 395-96. Based on these allegations, plaintiffs asserted claims under Sections 10(b) and 20(a) of the 1934 Act; and Section 36(b) of the Act. While plaintiffs' 1934 Act claims were initially dismissed, the Second Circuit reversed the District Court's decision with respect to the 1934 Act and remanded for further proceedings. Operating Local 649 Annuity Trust v. Smith Barney Fund Mgmt. LLC, 595 F.3d 86 (2d Cir. 2010). Defendants then filed another motion to dismiss.

With regard to scienter, one of the individual defendants—a senior vice president and director of Smith Barney and managing director of a unit of Citigroup Asset Management—argued that plaintiffs failed to allege scienter against him. The court soundly denied the individual's argument on the basis that the individual "helped evaluate the [transfer agency agreement], drafted a comprehensive

memorandum concerning its details, and presented the proposal to the Smith Barney Funds' boards. Then, over a four-year period, [the individual] signed numerous prospectuses that failed to disclose the transfer agent scheme. Accordingly, the Complaint adequately alleges that [the individual] knew facts or had access to information suggesting that [his] public statements were not accurate . . . ." In re Smith Barney, 765 F. Supp. 2d at 402 (citation omitted); see also id. (sustaining Section 20(a) claim against this individual).

Shockingly, lead plaintiffs' counsel subsequently informed the court that the lead plaintiff did not actually own shares in the at-issue fund (rather lead plaintiff owned shares in a similarly named fund). After excoriating the lawyers for both sides for letting this error go unnoticed for six years of litigation, the court dismissed lead plaintiff and set a briefing schedule for an appointment of a new lead plaintiff and lead counsel. See In re Smith Barney Transfer Agent Litig., No. 05 Civ. 7583, 2011 WL 4430857 (S.D.N.Y. Sept. 22, 2011).

After plaintiffs resolved the standing issue, plaintiffs re-filed their action, and defendants again moved to dismiss. The court ultimately dismissed the claims against the investment adviser and one of the individual defendants for failure to plead reliance, but sustained a Rule 10b-5(b) claim against the other individual defendant who had signed allegedly misleading fund documents. See infra In re Smith Barney Fund Transfer Agent Litig., No. 05 Civ. 7583, 2012 WL 3339098 (S.D.N.Y. Aug. 15, 2012).

2. Duty to Disclose

a. In Castillo v. Dean Witter Discover & Co., No. 97 Civ. 1272, 1998 WL 342050 (S.D.N.Y. June 25, 1998), plaintiffs alleged that defendants improperly influenced broker-dealers to promote their proprietary funds, that defendants failed to disclose their compensation policies, and that their funds had higher fees and performed worse than unaffiliated funds. Plaintiffs also alleged that defendants failed to adequately disclose the risks and fees of the proprietary funds. Plaintiffs claimed defendants' conduct violated Section 10(b) of the 1934 Act. The court granted defendants' motion to dismiss, however, as defendants did not have a duty to disclose: (1) information about the products of competitors; (2) that their brokers received more compensation for selling proprietary products than outside funds; or (3) that shares in proprietary funds were not transferable to other investment houses. See id. at *8-9.

b. In Benzon v. Morgan Stanley, No. 3:03-159, 2004 WL 62747 (M.D. Tenn. Jan. 8, 2004), plaintiffs brought claims under the 1933 Act, the 1934 Act, and common law against the fund's adviser alleging that the fund's prospectus failed to disclose the relative merits of purchasing Class A shares versus Class B shares. Specifically, plaintiffs claimed that defendants had a duty to disclose in the prospectus that investing in Class B shares was never "the best choice for any rational investment strategy." Id. at *1. In finding that defendants had no duty to make such statements about Class B shares in the prospectus, the court stated:

> [t]he prospectus at issue discloses information which would permit any investor to determine the "best" investment for him or her, under the circumstances. It is up to each investor to take the facts provided, evaluate options, make calculations, and decide on the best investment strategy for his or her particular circumstances, taking into account the myriad changes which occur daily, both in the market and in the individual's own financial situation. See Wallerstein v. Primerica Corp., 701 F. Supp. 393, 398 (E.D.N.Y. 1988) ("Full factual disclosures need not be embellished with speculative financial predictions."). So long as Defendants provide truthful information, then investors, with or without financial advisors, have the duty to decide was [sic] is "best" for them.

Benzon, 2004 WL 62747, at *4. The court noted that the prospectus disclosed the total amounts paid by investors to defendants for the various classes of shares and thus defendants "had no duty to provide more specific information in the prospectus concerning specific allocations or incentives given to brokers" for selling those different classes of shares. Id.

Plaintiffs appealed the district court ruling. See Benzon v. Morgan Stanley, 420 F.3d 598 (6th Cir. 2005). In sustaining the dismissal, the court noted that although defendants had no duty to disclose information about broker compensation, even if such a duty existed, the information contained in the subject prospectus did, in fact, address the purported omitted material. See id. at 612.

c. In In re Merrill Lynch Investment Management Funds Securities Litigation, 434 F. Supp. 2d 233 (S.D.N.Y. 2006), plaintiffs alleged Merrill Lynch and related defendants entered into agreements with certain mutual funds pursuant to which Merrill Lynch received payments from the funds in exchange for providing financial and other incentives to its sales force to sell the funds. Plaintiffs claimed that these distribution arrangements and Merrill Lynch's

failure to disclose them constituted violations of Sections 12 and 15 of the 1933 Act; Sections 10(b) and 20(a) of the 1934 Act; Sections 34(b), 36(a), 36(b), and 48(a) of the Act; Sections 206 and 215 of the Investment Advisers Act of 1940; and state law. With respect to the 1934 Act, the court held that defendants did not violate their duty to disclose because they "disclosed the fees and commissions charged to shareholders . . . [and the] precise allocation of those fees is not material under the securities laws." Id. at 238.

d. In In re Morgan Stanley & Van Kampen Mutual Fund Securities Litigation, No. 03 Civ. 8208, 2006 WL 1008138 (S.D.N.Y. Apr. 18, 2006), plaintiffs brought a myriad of claims relating to Morgan Stanley's revenue sharing program. According to plaintiffs, Morgan Stanley provided incentives to its sales force of registered representatives to promote the sales of its proprietary funds. Plaintiffs claimed that these sales incentives and Morgan Stanley's failure to disclose them violated Sections 11, 12 and 15 of the 1933 Act; Sections 10(b) and 20(a) of the 1934 Act; Sections 34(b), 36(b), and 48(a) of the Act; Sections 206 and 215 of the Investment Advisers Act of 1940; and state law. With respect to the 1934 Act claims, the court held that defendants had not violated their duty to disclose because "current SEC regulations impose no duty on defendants to disclose the allocation of broker compensation." Id. at *7. Citing Benzon v. Morgan Stanley Distribs., Inc., 420 F.3d 598 (6th Cir. 2005), the court stated that since defendants had disclosed the total fees to be paid by the investor, as well as the total commissions paid by the fund, defendants had abided by their duty to disclose. See id. at *7-8.

e. In Siemers v. Wells Fargo & Co., No. C 05-4518, 2006 WL 2355411 (N.D. Cal. Aug. 14, 2006), plaintiff asserted numerous claims relating to Wells Fargo's revenue sharing program. According to plaintiff, Wells Fargo and certain related defendants engaged in a purportedly undisclosed "scheme" to pay unaffiliated third party broker-dealers in an effort to induce their customers into purchasing Wells Fargo-branded mutual funds. Plaintiff alleged that he was harmed by: (1) receiving biased advice from broker-dealers; and (2) the dissipation of fund assets by paying purportedly "excessive" fees to the investment adviser and distributor defendants. Plaintiff claimed that these "kickback" arrangements and Wells Fargo's failure to disclose them constituted violations of Sections 12 and 15 of the 1933 Act; Sections 10(b) and 20(a) of the 1934 Act; and Sections 36(b) and 48(a) of the Act. With respect to plaintiff's 1934 Act claims, defendants argued that they had no duty to disclose anything more than that they "may consider sales of shares of the Fund . . . in the

selection of broker-dealers to execute the Fund's portfolio transaction." Id. at *5 (quoting the prospectus). The court disagreed, noting that the prospectus representation "left the impression that the payback arrangement might (or might not) materialize when it was, in reality, already a done deal." Id. at *5.

f. In In re Smith Barney Fund Transfer Agent Litigation, No. 05 Civ. 7583, 2007 WL 2809600 (S.D.N.Y. Sept. 26, 2007), plaintiffs alleged that defendants, the investment adviser and two of its officers, recommended that certain Smith Barney funds retain the services of Citicorp Trust Bank ("CTB"), an affiliate of the funds' investment adviser, to serve as the primary transfer agent for the funds. Although CTB was responsible for providing all of the Smith Barney-branded mutual funds' transfer agent services, CTB allegedly subcontracted the vast majority of the transfer agent work to First Data Investor Services Group ("First Data"). Plaintiffs alleged that pursuant to this subcontract, First Data charged significantly lower fees, yet defendants did not pass on or disclose those discounts to the funds. Id. at *1. Based on these allegations, plaintiffs asserted claims under Sections 10(b) and 20(a) of the 1934 Act and Section 36(b) of the Act. Defendants moved to dismiss the complaint in its entirety, including plaintiffs' 1934 Act claims, arguing, inter alia, that they were under no duty to disclose the exact allocation of fees. The court agreed, noting that "[w]here the total amount of fees paid by a mutual fund for various services is disclosed, other information about the fees, such as their allocation or the transfer agent's profit margin, is not material." Id. at 6 (citing In re Morgan Stanley & Van Kampen Mutual Fund Sec. Litig., No. 03 Civ. 8208, 2006 WL 1008138 (S.D.N.Y. Apr. 18, 2006)). Since it was undisputed that defendants had disclosed the total amount of fees paid by the funds, the court held that defendants had not made a material omission. See id. at *6-7.

One of the plaintiffs appealed the decision. On appeal, the United States Court of Appeals for the Second Circuit vacated and remanded with respect to the claims under Section 10(b) and Rule 10b-5. Operating Local 649 Annuity Trust Fund v. Smith Barney Fund Mgmt. LLC, 595 F.3d 86, 94 (2d Cir. 2010). The court held that the defendants, "under the guise of providing transfer agent services through CTB," "categorized fees that it ultimately pocketed as 'other fees' rather than management fees." Id. at 94-95. The court concluded that "[f]ew facts would likely constitute more important ingredients in investors' 'total mix' of information than the fact that, in violation of [SEC] disclosure requirements the expenses categorized as transfer agent fees were not transfer agent

fees at all and included kickbacks to CTB and ultimately, [the adviser].” Id.

Moreover, the court found compelling the SEC requirement that an adviser, when seeking approval for a fee increase, must issue a “comparative fee table . . . if any of the fee categories in the fee table would be increased . . . *regardless of whether total expenses would be increased*.” Id. at 94 (internal citations and quotations omitted).

Shockingly, after yet another motion to dismiss, lead plaintiffs’ counsel informed the court that the lead plaintiff did not actually own shares in the at-issue fund (rather lead plaintiff owned shares in a similarly named fund). After excoriating the lawyers for both sides for letting this error go unnoticed for six years of litigation, the court dismissed lead plaintiff and set a briefing schedule for an appointment of a new lead plaintiff and lead counsel. See In re Smith Barney Transfer Agent Litig., No. 05 Civ. 7583, 2011 WL 4430857 (S.D.N.Y. Sept. 22, 2011).

After plaintiffs resolved the standing issue, plaintiffs re-filed their action, and defendants again moved to dismiss. The court ultimately dismissed the claims against the investment adviser and one of the individual defendants for failure to plead reliance, but sustained a Rule 10b-5(b) claim against the other individual defendant who had signed allegedly misleading fund documents. See infra In re Smith Barney Fund Transfer Agent Litig., No. 05 Civ. 7583, 2012 WL 3339098 (S.D.N.Y. Aug. 15, 2012).

g. In Ulferts v. Franklin Resources, Inc., 554 F. Supp. 2d 568 (D.N.J. 2008), shareholders of several mutual funds alleged defendants failed to disclose a compensation scheme that caused unaffiliated broker-dealers to steer unwitting investors into Franklin-branded mutual funds. Specifically, plaintiffs alleged that the brokerage fees charged to the funds were improperly used to finance shelf-space arrangements to steer additional investors into defendants’ funds. Plaintiffs claimed defendants’ conduct violated Section 12(a)(2) of the 1933 Act; and Section 10(b) of the 1934 Act. Defendants moved to dismiss the complaint in its entirety, including the 1934 Act claims, arguing, inter alia, that they were under no obligation to disclose its shelf-space arrangements with unaffiliated broker-dealers. The court agreed, noting that plaintiffs’ claims were wholly inadequate because defendants “had no statutory or regulatory duty to disclose the shelf-space arrangements.” Id. at 575-76 (citing In re AIG Advisor Group, No. 06-CV-1625, 2007 WL 1213395, at *9 (E.D.N.Y. Apr. 25, 2007);

In re Morgan Stanley & Van Kampen Mutual Fund Sec. Litig., No. 03-CV-8208, 2006 WL 1008138, at *7 (S.D.N.Y. Apr. 18, 2007)).

On June 30, 2008, Judge Martini denied plaintiffs' motion for reconsideration or for leave to file an amended complaint. Ulferts v. Franklin Resources, Inc., 567 F. Supp. 2d 678, 682 (D.N.J. 2008). Plaintiffs argued that defendants were required to disclose shelf-space arrangements pursuant to SEC Form N1-A, and that their failure to do so was a violation of Section 10(b) of the 1934 Act. Id. at 680. Alternatively, plaintiffs requested that the court grant leave to amend their complaint to incorporate purportedly misleading portions of the funds' prospectuses describing shelf-space arrangements. Id. at 681-82. The court rejected both arguments, holding that Form N1-A required defendants to include details of the shelf-space arrangements only to the extent shareholders requested a Statement of Additional Information and that, regardless, defendants accurately disclosed these arrangements in the funds' prospectuses. Id.

h. In In re Mutual Funds Investment Litigation (In re RS Inv. Subtrack), 608 F. Supp. 2d 672 (D. Md. 2009), mutual fund investors brought actions alleging violations of, inter alia, Section 10(b) of the 1934 Act, based on defendants' involvement in market timing schemes. In granting summary judgment for defendants, Judge Motz found that defendants did not violate their duty to disclose. Id. at 674. Since defendants "'spoke' only about exchange limitations, and that statement cannot be construed as referring to market timing" the court found that plaintiffs did not identify any material misrepresentation or omission regarding market timing that defendants were under a duty to disclose. Id. at 674-75.

3. Materiality

a. In Benzon v. Morgan Stanley, No. 3:03-159, 2004 WL 62747 (M.D. Tenn. Jan. 8, 2004), plaintiffs brought claims under the 1933 Act, the 1934 Act, and common law against the fund's adviser alleging that the fund's prospectus failed to disclose the relative merits of purchasing Class A shares versus Class B shares. Specifically, plaintiffs claimed that defendants had a duty to disclose in the prospectus that investment in Class B shares was never "the best choice for any rational investment strategy." Id. at *1. Defendants moved to dismiss the complaint in its entirety, and the court agreed, holding, inter alia, that the alleged omissions were not material as a matter of law.

Plaintiffs appealed the district court's dismissal. See Benzon v. Morgan Stanley Distribs., Inc., 420 F.3d 598 (6th Cir. 2005). While the Sixth Circuit found that the alleged merits of purchasing Class A shares versus Class B shares might have been useful, the court concluded that since the omissions were "merely interpretations drawn from the facts presented in the prospectuses . . . they would not have significantly altered the total mix of the information already presented." Id. at 608. As a result, the court affirmed the lower court's dismissal of the complaint. See id.

b. In In re Merrill Lynch Investment Management Funds Securities Litigation, 434 F. Supp. 2d 233 (S.D.N.Y. 2006), plaintiffs alleged Merrill Lynch and related defendants entered into agreements with certain mutual funds pursuant to which Merrill Lynch received payments from the funds in exchange for providing financial and other incentives to its sales force to sell the funds. Plaintiffs claimed that these distribution arrangements and Merrill Lynch's failure to disclose them constituted violations of Sections 12 and 15 of the 1933 Act; Sections 10(b) and 20(a) of the 1934 Act; Sections 34(b), 36(a), 36(b), and 48(a) of the Act; Sections 206 and 215 of the Investment Advisers Act of 1940; and state law. Defendants moved to dismiss plaintiffs' claims, including those claims asserted pursuant to the 1934 Act. Defendants argued, inter alia, that they were not required to disclose the exact nature of the sales incentives because such incentives and corresponding sales practices were not material as a matter of law. The court agreed, noting that defendants did not violate their duty to disclose because they "disclosed the fees and commissions charged to shareholders . . . [and the] precise allocation of those fees is not material under the securities laws." Id. at 238.

c. In In re Morgan Stanley & Van Kampen Mutual Fund Securities Litigation, No. 03 Civ. 8208, 2006 WL 1008138 (S.D.N.Y. Apr. 18, 2006), plaintiffs brought a myriad of claims relating to Morgan Stanley's revenue sharing program. According to plaintiffs, Morgan Stanley provided incentives to its sales force of individual registered representatives to promote the sales of its proprietary funds. Plaintiffs claimed that these sales incentives and Morgan Stanley's failure to disclose them constituted violations of Sections 11, 12 and 15 of the 1933 Act; Sections 10(b) and 20(a) of the 1934 Act; Sections 34(b), 36(b), and 48(a) of the Act; Sections 206 and 215 of the Investment Advisers Act of 1940; and state law. Defendants moved to dismiss the complaint in its entirety, including the 1934 Act claims. After analyzing the standards by which 1934 Act claims are judged, the court found that defendants were under no obligation to disclose its sales practices and corresponding payments to its sales force because "minimum

payments . . . are not material under the securities laws." Id. at *8 (citing Feinman v. Dean Witter Reynolds, Inc., 84 F.3d 539, 541 (2d Cir. 1996)). Since the participation fees and sales contests "were primarily of minimum value" and plaintiffs failed to allege "that the proportion of sales of proprietary funds had a more than minimal impact on the amounts of [an advisor's] bonus," defendants' omissions were not material. See id.

d. In Siemers v. Wells Fargo & Co., No. C 05-4518, 2006 WL 2355411 (N.D. Cal. Aug. 14, 2006), plaintiff asserted numerous claims relating to Wells Fargo's revenue sharing program. According to plaintiff, Wells Fargo and certain related defendants engaged in a purportedly undisclosed "scheme" to pay unaffiliated third party broker-dealers in an effort to induce their customers into purchasing Wells Fargo-branded mutual funds. Plaintiff alleged that he was harmed by: (1) receiving biased advice from broker-dealers; and (2) the dissipation of fund assets by paying purportedly "excessive" fees to the investment adviser and distributor defendants. Plaintiff claimed that these "kickback" arrangements and Wells Fargo's failure to disclose them constituted violations of Sections 12 and 15 of the 1933 Act; Sections 10(b) and 20(a) of the 1934 Act; and Sections 36(b) and 48(a) of the Act. With respect to the 1934 Act claims, plaintiff alleged that defendants had a duty to disclose the exact nature of the payment arrangements with unaffiliated broker-dealers. Defendants moved to dismiss the complaint. The court denied the motion, holding that the alleged misstatement "left the impression that the payback arrangement might . . . materialize when it was, in reality, already a done deal." Id. at *5. The court found this misstatement to be material because a "reasonable investor is more likely to view the broker-dealer's recommendation with skepticism if he . . . knows for sure that the broker-dealer's objectivity has already been compromised, as opposed to the mere possibility that the broker-dealer's objectivity might . . . be compromised." Id. at *6.

Coming to this conclusion, the court distinguished a number of cases. First, considering In re Morgan Stanley & Van Kampen Mutual Fund Securities Litigation, No. 03 Civ. 8208, 2006 WL 1008138 (S.D.N.Y. Apr. 18, 2006), the court stated Wells Fargo had allegedly received 100 basis points and 70 basis points more than Morgan Stanley did for holding equity fund shares and fixed-income fund shares, respectively. See Siemers, 2006 WL 2355411, at *7. The court also considered Castillo v. Dean Witter Discover & Co., No. 97 Civ. 1272, 1998 WL 342050 (S.D.N.Y. June 25, 1998), where Dean Witter did not disclose that their brokers received greater compensation for selling shares of

proprietary funds. While Dean Witter held these omissions to be immaterial, reasoning that such favoritism for proprietary funds is expected, the Siemers court distinguished the case because plaintiff alleged his broker-dealer received extra payments for selling funds of independent companies, which would be unexpected. See Siemers, 2006 WL 2355411, at *8. Finally, the court declined to follow Benzon v. Morgan Stanley, 420 F.3d 598 (6th Cir. 2005), where the Sixth Circuit called the difference between whether a broker-dealer "may receive" or "will receive" a payment a "semantic quibble." See Siemers, 2006 WL 2355411, at *7.

In response to dismissal on other grounds, plaintiff filed a third amended complaint that contained substantially similar 1934 Act claims. See Siemers v. Wells Fargo & Co., No. C 05-4518, 2007 WL 1140660 (N.D. Cal. Apr. 17, 2007). Defendants moved to dismiss the complaint, again arguing that plaintiff's 1934 Act claims were deficient for failing to adequately allege materiality. The court disagreed, noting that the amount of complained-of revenue sharing "was more than twenty times the rule 12b-1 fees, which were disclosed as the fees for ongoing distribution." Id. at *6 (citation omitted). Since investors seemingly received no benefit for these payments, the court held that this "would have been significant in the total mix of information for making an investment decision." Id.

e. In In re AIG Advisor Group Securities Litigation, No. 06 Civ. 1625, 2007 WL 2750676 (E.D.N.Y. Sept. 20, 2007), plaintiffs alleged defendants improperly influenced their brokers to steer unwitting investors into certain mutual funds in exchange for "kickback" payments through revenue sharing and other incentives. Plaintiffs' second amended complaint alleged these activities violated, inter alia, Sections 10(b) and 20(a) of the 1934 Act. Defendants moved to dismiss the complaint in its entirety. With respect to the materiality of the alleged omissions, the court noted that plaintiffs failed to allege with the requisite particularity the level of assets the subject financial advisors stood to receive for the purported improper conduct. Furthermore, the court found that even in those instances where an alleged payment level was, in fact, specified, the amount was so low so as not to be capable of biasing an advisors' judgment. While the Second Circuit affirmed this decision on different grounds, the court noted that "we express no view on the District Court's materiality and standing rulings." See In re AIG Advisor Group Sec. Litig., 309 F. App'x 495, 498 n.3 (2d Cir. 2009).

f. In In re Smith Barney Fund Transfer Agent Litigation, No. 05 Civ. 7583, 2007 WL 2809600 (S.D.N.Y. Sept. 26, 2007), plaintiffs

alleged that defendants, the investment adviser and two of its officers, recommended that certain Smith Barney funds retain the services of Citicorp Trust Bank ("CTB"), an affiliate of the funds' investment adviser, to serve as the primary transfer agent for the funds. Although CTB was responsible for providing all of the Smith Barney-branded mutual funds' transfer agent services, CTB allegedly subcontracted the vast majority of the transfer agent work to First Data Investor Services Group ("First Data"). Plaintiffs alleged that pursuant to this subcontract, First Data charged significantly lower fees, yet defendants did not pass on or disclose those discounts to the funds. Id. at *1. Based on these allegations, plaintiffs asserted claims under Sections 10(b) and 20(a) of the 1934 Act; and Section 36(b) of the Act.

Defendants moved to dismiss the complaint in its entirety, including the 1934 Act claims, arguing, inter alia, that they were under no duty to disclose the exact allocation of fees. The court agreed, noting that "[w]here the total amount of fees paid by a mutual fund for various services is disclosed, other information about the fees, such as their allocation or the transfer agent's profit margin, is not material." Id. at *6 (citing In re Morgan Stanley & Van Kampen Mutual Fund Sec. Litig., No. 03 Civ. 8208, 2006 WL 1008138 (S.D.N.Y. Apr. 18, 2006)). Since it was undisputed that defendants had disclosed the total amount of fees paid by the funds, the court held that defendants had not made a material omission. See id. at *6-7. The court distinguished Siemers v. Wells Fargo & Co., No. 05 Civ. 04518, 2006 U.S. Dist. LEXIS 60858 (N.D. Cal. Aug. 14, 2006), by noting that it was the receipt of biased advice that led the court in that case to conclude that the undisclosed profits constituted a material omission. Since plaintiffs in Smith Barney had made no such allegations about the advice they had received, the court found that plaintiffs had failed to state a claim under Section 10(b). See id. at *8.

On February 16, 2010, the Second Circuit vacated and remanded the district court's dismissal of plaintiffs' 1934 Act claims. See Operating Local 649 Annuity Trust v. Smith Barney Fund Mgmt. LLC, 595 F.3d 86 (2d Cir. 2010). The court held that even though defendants did not misrepresent the total fees charged to the fund, investors could still be mislead by the contents of the offering materials. Indeed, the Second Circuit found that it was substantially likely that a reasonable investor would view the undisclosed fee arrangement as significant. Id. at 93. The court also held that SEC disclosure requirements (including, among other things, the fact that Form N-1A requires investment advisers to distinguish between "management fees" and "other expenses"),

supported the conclusion that information regarding fees charged for each specific service is important to investors. Id. at 93-94.

Shockingly, after yet another motion to dismiss, lead plaintiffs' counsel informed the court that the lead plaintiff did not actually own shares in the at-issue fund (rather lead plaintiff owned shares in a similarly named fund). After excoriating the lawyers for both sides for letting this error go unnoticed for six years of litigation, the court dismissed lead plaintiff and set a briefing schedule for an appointment of a new lead plaintiff and lead counsel. See In re Smith Barney Transfer Agent Litig., No. 05 Civ. 7583, 2011 WL 4430857 (S.D.N.Y. Sept. 22, 2011).

After plaintiffs resolved the standing issue, plaintiffs re-filed their action, and defendants again moved to dismiss. The court ultimately dismissed the claims against the investment adviser and one of the individual defendants for failure to plead reliance, but sustained a Rule 10b-5(b) claim against the other individual defendant who had signed allegedly misleading fund documents. See infra In re Smith Barney Fund Transfer Agent Litig., No. 05 Civ. 7583, 2012 WL 3339098 (S.D.N.Y. Aug. 15, 2012).

g. In Garber v. Legg Mason, Inc., 537 F. Supp. 2d 597 (S.D.N.Y. 2008), Judge Chin dismissed investors' claims against Legg Mason and a number of its officers. Plaintiffs alleged violations of Sections 11, 12(a)(2) and 15 of the 1933 Act; and Sections 10(b) and 20(a) of the 1934 Act, stemming from purported misrepresentations made by defendants with respect to the share price of a secondary offering of Legg Mason common stock following its acquisition in an asset swap of substantially all of Citigroup's worldwide asset management division. Id. at 604-09. Specifically, plaintiffs alleged that the secondary offering's registration statement and announcements made after the offering omitted or misrepresented several matters, including: (1) that one of Legg Mason's top asset managers was leaving the firm following the asset swap; (2) that Legg Mason was experiencing a significant increase in customer withdrawals as a result of broker attrition due to the asset swap; (3) that Legg Mason was experiencing a dramatic increase in expenses in integrating the Citigroup infrastructure; and (4) that Legg Mason owed and failed to pay approximately $12 million in distribution fees owed by one of the Citigroup entities Legg Mason acquired. Id. at 607-08. With respect to the integration expenses, Judge Chin held that plaintiffs' complaint was "too conclusory" to assess its materiality. Id. at 613, 616-17. Additionally, the court held that the unpaid $12 million in distribution fees was "too small to be material as a matter of law." Id. Judge Chin's decision was subsequently

affirmed by the Second Circuit. See Garber v. Legg Mason, Inc., No. 08-1831, 2009 WL 3109914 (2d Cir. Sept. 20, 2009).

h. In Kreek v. Wells Fargo & Co., 652 F. Supp. 2d 1053 (N.D. Cal. 2009), mutual fund investors filed suit under Sections 10(b) and 20(a) of the 1934 Act, claiming that defendants engaged in undisclosed revenue sharing arrangements. The action was a "sequel" to the "heavily litigated" Siemers v. Wells Fargo action. According to plaintiffs, defendants paid kickbacks to broker-dealers and selling agents to steer clients into defendants' funds, regardless of whether those funds were the best option for investors. Plaintiffs claimed that the kickbacks were financed by hidden fees, the proceeds of which should have been invested in the funds' underlying portfolios. In denying defendants' motion to dismiss, Judge Alsup rejected defendants' contention that plaintiffs failed to allege the materiality of any statements or omissions. Specifically, Judge Alsup concluded that plaintiffs' revenue sharing allegations were material because the "secret . . . payments not only shrank plaintiffs' investments but they created conflicts of interest that any investor would want to know about . . . ." Id. at 1062.

i. In Bachow v. Swank Energy Income Advisers, LP, No. 3:09-CV-262, 2010 WL 70520 (N.D. Tex. Jan. 6, 2010), an investor brought claims under Sections 10(b) and 20(a) of the 1934 Act; and Section 36(b) of the Act, against the fund's investment adviser, its affiliate, and several adviser executives and fund independent trustees. Plaintiff alleged that defendants misrepresented the fund's investment strategy and holdings, and that when "adverse information [regarding these topics] was disclosed to the public," the value of the fund's shares "plummeted." Id. at *1. In denying defendants' motion to dismiss the Section 10(b) claims, the court found that plaintiff had sufficiently pleaded that defendants allegedly made materially misleading statements and omissions. Focusing on plaintiff's allegations that defendants had misled investors regarding the fund's assets, its investment strategy, the adequacy of its valuation measures, and the compensation that the investment adviser received, the court held that statements going to these topics were material because they "would have been important to a reasonable investor." Id. at *3-5 (citation omitted). The court also held that defendants could not avail themselves of the PSLRA's safe harbor for forward-looking statements because plaintiff pleaded "facts that—if true—would show that Defendants had knowledge of the falsity of their statements or omissions." Id. at *5.

4. Loss Causation

a. In Castillo v. Dean Witter Discover & Co., No. 97 Civ. 1272, 1998 WL 342050 (S.D.N.Y. June 25, 1998), plaintiffs alleged defendants improperly influenced broker-dealers to promote their proprietary funds, that defendants failed to disclose their compensation policies, and that their funds had higher fees and performed worse than unaffiliated funds. Plaintiffs also alleged that defendants failed to adequately disclose the risks and fees of the proprietary funds. Plaintiffs claimed defendants' conduct violated Section 10(b) of the 1934 Act. Defendants moved to dismiss the complaint in its entirety, arguing, inter alia, that plaintiffs failed to plead loss causation. Plaintiffs argued that loss causation was not a required element, but the court cited to the PSLRA in summarily rejecting plaintiffs' contention. See id. at *4-5. The court held that plaintiffs had not pleaded loss causation, noting that although the complaint contained allegations sufficient to demonstrate transaction causation, plaintiffs had not explained why the alleged misstatements were responsible for their damages. See id. at *5. Specifically, the court noted how plaintiffs failed to tie the allocation of fees and commissions between defendants and brokers, or the nature of the investments, to their purported damages. See id. at *5-6.

b. In In re Merrill Lynch Investment Management Funds Securities Litigation, 434 F. Supp. 2d 233 (S.D.N.Y. 2006), plaintiffs alleged Merrill Lynch and related defendants entered into agreements with certain mutual funds pursuant to which Merrill Lynch received payments from the funds in exchange for providing financial and other incentives to its sales force to sell the funds. Plaintiffs claimed these distribution arrangements and Merrill Lynch's failure to disclose them constituted violations of Sections 12 and 15 of the 1933 Act; Sections 10(b) and 20(a) of the 1934 Act; Sections 34(b), 36(a), 36(b), and 48(a) of the Act; Sections 206 and 215 of the Investment Advisers Act of 1940; and state law. Defendants moved to dismiss the complaint in its entirety, including the 1934 Act claims, arguing, inter alia, that plaintiffs failed to allege loss causation. The court agreed, holding that it was "apparent on the face of the complaint that plaintiffs [had] not pleaded losses, let alone a loss fairly traceable to defendants." Id. at 238. Specifically, the court found that paying for disclosed fees or losing the opportunity to invest in a different fund, were not bases for damages under the 1934 Act. See id.

c. In In re Morgan Stanley & Van Kampen Mutual Fund Securities Litigation, No. 03 Civ. 8208, 2006 WL 1008138 (S.D.N.Y. Apr. 18, 2006), plaintiffs brought a myriad of claims relating to Morgan

Stanley's revenue sharing program. According to plaintiffs, Morgan Stanley provided incentives to its sales force of registered representatives to promote the sales of its proprietary funds. Plaintiffs claimed that these sales incentives and Morgan Stanley's failure to disclose them constituted violations of Sections 11, 12 and 15 of the 1933 Act; Sections 10(b) and 20(a) of the 1934 Act; Sections 34(b), 36(b), and 48(a) of the Act; Sections 206 and 215 of the Investment Advisers Act of 1940; and state law. Defendants moved to dismiss the complaint in its entirety, including the 1934 Act claims. The court found that plaintiffs had not pleaded loss causation because they failed to plead a cognizable loss in alleging they were injured by defendants' overvaluing of the proprietary fund shares. See id. at *8-10. Since all "fees charged to the shareholder were disclosed in the offering prospectuses . . . [t]he allocation of the fees [was] immaterial, because it could have no effect on share price." Id. at *9 (citing Castillo v. Dean Witter Discover & Co., No. 97 Civ. 1272, 1998 WL 342050 (S.D.N.Y. June 25, 1998)). The court also noted that plaintiffs did not allege any facts showing that any alleged nondisclosures proximately caused their alleged losses. See id. at *10. Similarly, the court noted that plaintiff "fail[ed] to allege that a broker's misrepresentation caused any loss [or] any connection between the conduct of any broker and the poor performance of a fund or other loss." Id.

d. In In re Salomon Smith Barney Mutual Fund Fees Litigation, 441 F. Supp. 2d 579 (S.D.N.Y. 2006), plaintiffs alleged that Salomon Smith Barney ("SSB") and certain affiliated entities engaged in a scheme that consisted of: (1) SSB offering undisclosed incentives to brokers and financial advisors to steer investors into SSB's proprietary funds and other funds with which SSB had undisclosed "kickback" arrangements; (2) SSB extracting improper fees from investors in its proprietary funds; and (3) SSB causing its proprietary funds to invest in poorly performing companies because of their status as SSB investment banking clients. See id. at 583-85. Plaintiffs claimed that this purported scheme constituted violations of, inter alia, Sections 10(b) of the 1934 Act. Defendants moved to dismiss plaintiffs' 1934 Act claims arguing, inter alia, that the complaint failed to plead loss causation. The court agreed, noting that plaintiffs failed to allege why they lost money on their investment and why the loss was "for the precise reason complained of. . . ." Id. at 591. The court held that plaintiffs failed to establish loss causation with respect to their allegations of improper fees because: (1) plaintiffs' claims fall outside of the federal securities scheme absent a link between such fees and the funds' decline; and (2) where defendants "disclosed the total fees . . . , allocation of fees would not affect mutual fund

share value." See id. at 590 (citing Castillo v. Dean Witter Discover & Co., No. 97 Civ. 1272, 1998 WL 342050 (S.D.N.Y. June 25, 1998)).

e. In Siemers v. Wells Fargo & Co., No. C 05-4518, 2006 WL 2355411 (N.D. Cal. Aug. 14, 2006), plaintiff asserted numerous claims relating to Wells Fargo's revenue sharing program. According to plaintiff, Wells Fargo and certain related defendants engaged in a purportedly undisclosed "scheme" to pay unaffiliated third party broker-dealers in an effort to induce their customers into purchasing Wells Fargo-branded mutual funds. Plaintiff alleged that he was harmed by: (1) receiving biased advice from broker-dealers; and (2) the dissipation of fund assets by paying purportedly "excessive" fees to the investment adviser and distributor defendants. Plaintiff claimed that these "kickback" arrangements and Wells Fargo's failure to disclose them constituted violations of Sections 12 and 15 of the 1933 Act; Sections 10(b) and 20(a) of the 1934 Act; and Sections 36(b) and 48(a) of the Act. Defendants moved to dismiss the complaint in its entirety, including the 1934 Act claims, arguing, inter alia, that plaintiff failed to allege loss causation. The court disagreed, noting that plaintiff alleged that had the purported "kickbacks" not been paid, the funds would have been larger and their net returns would have been greater. See id. at *12. While defendants argued that since the total amount of fees was disclosed, plaintiff could not suffer a loss from them, the court reasoned that plaintiff's claims went to why the fees were paid and not how much were paid in total, and that this loss causation theory was "plausible enough at the Rule 12 stage." See id.

f. In In re Mutual Funds Investment Litigation (In re Janus and Putnam Subtracks), 590 F. Supp. 2d 741 (D. Md. 2008), mutual fund investors brought actions alleging violations of, inter alia, Section 10(b) of the 1934 Act, based on defendants' involvement in market timing schemes. In their motion for summary judgment, defendants argued, citing Dura Pharmaceuticals v. Broudo, 544 U.S. 336 (2005), that plaintiffs could not satisfy the loss causation requirement because they had not shown that an inflated purchase price followed by a corrective disclosure by defendants led to a drop in the mutual funds' share price. Id. at 748. Judge Motz rejected defendants' argument, holding that the "truth, then price drop" formulation was not the only means of showing loss causation. Id. (citation omitted). Instead, it was sufficient to prove that "the very facts about which the defendants lied caused the plaintiffs' injuries." Id. (citations and quotation omitted). Thus, plaintiffs' allegations that their investment losses "stemmed from dilution of the value of their shares, increased administrative costs

incurred by the funds, and . . . 'flight damages'" as a result of the market timing activities, were sufficient to survive summary judgment. Id.

g. In In re Mutual Funds Investment Litigation (First Derivative Traders v. Janus Capital Group, Inc.), 566 F.3d 111 (4th Cir. 2009), rev'd sub nom. Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296 (2011), investors in the parent company (Janus Capital Group, hereinafter "JCG") of an investment adviser (Janus Capital Management, hereinafter "JCM"), appealed the dismissal of their claims asserting violations of Sections 10(b) and 20(a) of the 1934 Act based on defendants' involvement in market timing schemes. With regard to loss causation, plaintiffs alleged that because "misleading statements regarding defendants' policies on market timing fraudulently induced investors to purchase shares in the Janus funds . . . [and] JCM's management of the Janus funds' assets was responsible for generating more than ninety percent of JCG's revenue . . . , any decrease in the value of the assets in the various mutual funds would adversely affect JCG's revenues and profits." Id. at 128.

Reversing the district court's opinion, the Fourth Circuit held that such allegations adequately pled loss causation because the "rapid decline of JCG's common stock price following the news of market timing in the Janus funds indicates a substantial causal link between the misleading prospectuses used to sell shares in the Janus funds and the value of JCG's stock." Id. at 129. In arriving at this conclusion, the Fourth Circuit credited plaintiffs' allegations relating to the fines and penalties that JCG paid relating to market timing allegations, as well as the decrease in assets under management for JCM that occurred after news broke of alleged market timing in the Janus funds. Id. at 128-29.

The Supreme Court granted JCG's and JCM's petition for certiorari and reversed the Fourth Circuit's decision. See Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296 (2011). For a more in-depth discussion of the Supreme Court's decision, please see the description of this case in § V.B.5.d below.

h. In Kreek v. Wells Fargo & Co., 652 F. Supp. 2d 1053 (N.D. Cal. 2009), mutual fund investors filed suit under Sections 10(b) and 20(a) of the 1934 Act, claiming that defendants engaged in undisclosed revenue sharing arrangements. The action was a "sequel" to the "heavily litigated" Siemers v. Wells Fargo action. According to plaintiffs, defendants paid kickbacks to broker-dealers and selling agents to steer clients into defendants' funds, regardless of whether those funds were the best option for

investors. Plaintiffs claimed that the kickbacks were financed by hidden fees, the proceeds of which should have been invested in the funds' underlying portfolios. In denying defendants' motion to dismiss, Judge Alsup found that plaintiffs had pleaded loss causation. Specifically, Judge Alsup concluded that since plaintiffs alleged that the revenue sharing payments were decreasing the "net assets of the fund and reduced its ability to earn income," plaintiffs had pleaded that defendants' omissions proximately caused plaintiffs' losses regardless of whether "there was no drop in share value after the truth was revealed." Id. at 1064 (quotations omitted).

i. In Gosselin v. First Trust Advisors, L.P., No. 08 C 5213, 2009 WL 5064295 (N.D. Ill. Dec. 17, 2009), mutual fund investors asserted violations of Sections 11, 12(a)(2), and 15 of the 1933 Act; and Sections 10(b), 14(a), and 20(a) of the 1934 Act, stemming from plaintiffs' investment in mutual funds that had exposure to residential mortgage-backed securities and other "risky" assets. With regard to plaintiffs' 1934 Act claims, the court found that plaintiffs had pleaded loss causation because plaintiffs alleged that while "the Funds' shares allegedly declined along with the market, after the Funds made certain disclosures, the value of the Funds' shares substantially declined." Id. at *7. The court also noted that plaintiffs "created an inference that the Defendants' partial disclosures were a substantial reason" for certain "across-the-board decreases" in share prices. Id.

j. In Bachow v. Swank Energy Income Advisers, LP, No. 3:09-CV-262, 2010 WL 70520 (N.D. Tex. Jan. 6, 2010), an investor brought claims under Sections 10(b) and 20(a) of the 1934 Act; and Section 36(b) of the Act, against the fund's investment adviser, its affiliate, and several adviser executives and fund independent trustees. Plaintiff alleged that defendants misrepresented the fund's investment strategy and holdings, and that when "adverse information [regarding these characteristics] was disclosed to the public," the value of the fund's shares "plummeted." Id. at *1. In denying defendants' motion to dismiss the Section 10(b) claims, the court found that plaintiff had pleaded loss causation. Specifically, the court found that because the fund's share price fell "50%" after the alleged misrepresentations and omissions came to light, "[t]here can be no doubt that this provides Defendants with at least some notice of the loss and the connection Plaintiff sees to the Defendants' alleged misrepresentations and then subsequent revelation of the truth." Id. at *8.

k. In Operating Local 649 Annuity Trust v. Smith Barney Fund Management LLC, 595 F.3d 86 (2d Cir. 2010), the Second Circuit

reversed the lower court's dismissal of claims brought under Section 10(b) of the 1934 Act. Plaintiffs alleged that defendants had recommended that the Smith Barney funds retain the services of Citicorp Trust Bank ("CTB"), an affiliate of the funds' investment adviser, to serve as the primary transfer agent for the funds. Although CTB was responsible for providing all of the Smith Barney-branded mutual funds' transfer agent services, CTB allegedly subcontracted the vast majority of the transfer agent work to First Data Investor Services Group ("First Data"). Plaintiffs alleged that pursuant to this subcontract, First Data charged significantly lower fees, yet defendants did not pass on or disclose those discounts to the funds. See id. at 89-91.

With regard to loss causation, defendants argued that because it had disgorged to the funds all of its profits from the transfer agent agreements, plaintiffs had not suffered any damages. The court, however, held that, at the motion to dismiss stage, there was no factual record that could support that the restitution payments had actually made plaintiffs whole. Likewise, the court rejected defendants' argument that plaintiffs would not be able to prove that the transfer agent fee arrangement caused them harm, since defendants disclosed the total amount of fees paid by the funds. Rather, the court held that defendants' misrepresentations "caused investors to make *and maintain* investments in Funds that were subject to excessive fees and expenses," which, in turn, "negatively and predictably impacted [the funds'] returns." Id. at 95-96 (emphasis in original).

Shockingly, after the case was remanded and there was yet another motion to dismiss, lead plaintiffs' counsel informed the district court that the lead plaintiff did not actually own shares in the at-issue fund (rather lead plaintiff owned shares in a similarly named fund). After excoriating the lawyers for both sides for letting this error go unnoticed for six years of litigation, the court dismissed lead plaintiff and set a briefing schedule for an appointment of a new lead plaintiff and lead counsel. See In re Smith Barney Transfer Agent Litig., No. 05 Civ. 7583, 2011 WL 4430857 (S.D.N.Y. Sept. 22, 2011).

After plaintiffs resolved the standing issue, plaintiffs re-filed their action, and defendants again moved to dismiss. The court ultimately dismissed the claims against the investment adviser and one of the individual defendants for failure to plead reliance, but sustained a Rule 10b-5(b) claim against the other individual defendant who had signed allegedly misleading fund documents. See infra In re Smith Barney Fund Transfer Agent Litigation, No. 05 Civ. 7583, 2012 WL 3339098 (S.D.N.Y. Aug. 15, 2012).

5. Miscellaneous

a. In In re American Funds Securities Litigation, 556 F. Supp. 2d 1100 (C.D. Cal. 2008), Judge Feess dismissed plaintiffs' action alleging violations of various provisions of the 1933 Act and the 1934 Act on statute of limitations grounds. Plaintiffs' claim, which was filed in December of 2006, alleged that defendants paid kickbacks to brokers to steer investors into purchasing defendants' mutual funds. With respect to the claims arising under the 1934 Act, Judge Feess found that plaintiffs were on inquiry notice for purposes of the statute of limitations more than two years prior to the filing of the complaint through a variety of publicly-available information, including: (1) news articles about so-called "revenue sharing" in the mutual fund industry dating back to November 2003; (2) SEC administrative proceedings against similar firms for similar practices, dating back to November 2003; and (3) a July 2004 complaint based on the same conduct filed by a different group of plaintiffs. Id. at 1105-09. The court thus found that "the public record by late 2003 contained information that not only put investors on notice of a possible fraud, but delineated the facts constituting how the scheme worked," and thus held that plaintiffs had not acted in a reasonably diligent manner in bringing the lawsuit and dismissed the claims with prejudice. Id. at 1110-11.

Plaintiffs appealed the decision to the Ninth Circuit. After the appeal had been fully briefed and argued but not decided, the Supreme Court decided Merck & Co., Inc. v. Reynolds, 130 S. Ct. 1784 (2010), in which the Court construed the statute of limitations under Section 10(b) of the Exchange Act. In light of Merck, the Ninth Circuit remanded the case for further proceedings. See In re Am. Funds Secs. Litig., No. CV 06-7815, 2011 WL 1827220 (C.D. Cal. Feb. 22, 2011).

After accepting briefing on the impact of Merck, if any, on the district court's original decision, the district court concluded that it had analyzed the claims in a manner consistent with the Supreme Court's decision in Merck and that "a reasonably diligent plaintiff should have known the facts giving rise to the pending complaints more than two years before these complaints were filed." Id. at *2. The court reiterated and incorporated by reference its prior ruling granting the motion to dismiss with prejudice. Id. Plaintiffs appealed the decision.

On July 20, 2012, the Ninth Circuit held that the district court erred in dismissing the action as time-barred, but affirmed the district court's dismissal because plaintiffs' complaint failed to allege scienter with the requisite particularity. In re Am. Funds Secs.

Litig., 479 F. App'x 782, 783 (9th Cir. 2012). The Ninth Circuit vacated the portion of the district court's order dismissing the case with prejudice, and remanded "for the limited purpose of granting plaintiffs leave to amend." Id. Following the remand to the district court, on January 18, 2013, the court entered an order dismissing the action following plaintiffs' voluntary dismissal. In re Am. Funds Secs. Litig., No. 2:06-cv-7815 (C.D. Cal. Jan. 18, 2013).

b. In In re AIG Advisor Group Securities Litigation, 309 F. App'x 495 (2d Cir. 2009), plaintiffs appealed from a judgment granting defendants' motion to dismiss. Plaintiffs, who had purchased mutual fund shares from defendants, claimed that defendants had violated Sections 10(b) and 20(a) of the 1934 Act by failing to disclose that they had pushed their financial advisors to sell plaintiffs certain funds "that provided undisclosed payments, financial incentives and rewards to AIG or its affiliates in exchange for kickbacks." Id. at 497 (quotation omitted). Affirming the district court's judgment on different grounds,[26] the Second Circuit found that the timing of certain website disclosures, which plaintiffs incorporated by reference in their complaint, "triggered the applicable statute of limitations" because almost all of those disclosures were published more than two years before plaintiffs filed their complaint, and because those disclosures, along with other "preexisting disclosures," were sufficient to place plaintiffs on inquiry notice of the alleged fraud. Id. at 498 & n.4. The Second Circuit also concluded that plaintiffs' claims were deficient because the website disclosures detailed "the existence of the very 'conflict of interest' [i.e., the payments made by defendants that were] at the heart of plaintiffs' complaint, barring any claim based thereon." Id. at 498.

c. In In re Mutual Funds Investment Litigation (In re RS Inv. Subtrack), 608 F. Supp. 2d 672 (D. Md. 2009), mutual fund investors brought actions alleging violations of, inter alia, Section 10(b) of the 1934 Act, based on defendants' involvement in market timing schemes. In granting summary judgment for defendants, Judge Motz found that plaintiffs failed to demonstrate reliance on the alleged false statement. Id. at 675-76. Citing Bourke v. Jacoby, 981 F.2d 1372, 1378 (2d Cir. 1992), Judge Motz found the presumption of reliance first established in Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128 (1972), to be inapplicable

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[26] The court stated that "[b]ecause we affirm on these grounds, we express no view on the District Court's materiality and standing rulings." In re AIG, 309 F. App'x at 498 n.3.

because that presumption only applies to establishing reliance on alleged omissions, and "the prospectuses contained no material omission as to market timing." In re Mutual Funds, 608 F. Supp. 2d at 676.

d. In In re Mutual Funds Investment Litigation (First Derivative Traders v. Janus Capital Group, Inc.), 566 F.3d 111 (4th Cir. 2009), rev'd sub nom. Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296 (2011), investors in the parent company of an investment adviser appealed the dismissal of their claims asserting violations of Sections 10(b) and 20(a) of the 1934 Act based on defendants' involvement in market timing schemes. Reversing the district court's opinion, the Fourth Circuit held that plaintiffs had pled reliance by satisfying the fraud-on-the-market presumption.

With regard to reliance, the issue before the Fourth Circuit was whether certain disclosures in the funds' prospectuses regarding market timing could be attributed to the parent company (Janus Capital Group hereinafter, "JCG") and the investment adviser (Janus Capital Management, hereinafter "JCM"), even though the disclosures were not attributable to JCG or JCM on their face. Id. at 124.

With regard to JCM, the Fourth Circuit found that for purposes of a motion to dismiss, plaintiffs had established an inference that JCM played "a role in the preparation or approval of the allegedly misleading . . . prospectuses" by alleging that: (1) JCM provided an extensive array of services to the Janus funds and was responsible for implementing the policies that allegedly were misleadingly described in the funds' prospectuses; and (2) JCM and the funds "held themselves out to the investing public as a single entity: 'Janus.'" Id. at 127.[27]

The court did not find that the statements were attributable to the "investment adviser's parent company," however, as "dissemination of the fund prospectuses on the Janus website . . . is insufficient . . . for us to infer that interested investors would believe JCG had prepared or approved the Janus fund prospectuses." Id. at 128. Notably, the Fourth Circuit panel was divided on this point, as one panel member found that the

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[27] The Fourth Circuit stressed, however, that the case "ar[ose] in the limited context of fraud-on-the-market," and it expressly declined to "establish an attribution standard for all reliance inquiries." In re Mutual Funds, 566 F.3d at 123.

disclosures were attributable to JCG. See id. at 131-32 (Shedd, J., concurring).

While plaintiffs also alleged that JCG was liable under Section 10(b) for participating in a fraudulent scheme, the Fourth Circuit noted that the "the existence of a fraudulent scheme does not permit a plaintiff to avoid proving any of the traditional elements of primary liability, such as scienter and reliance. Since we have already analyzed the challenged elements for primary liability for each of the defendants above, there is no need for us to conduct a separate inquiry on scheme liability." Id. at 129.

Finally, the Fourth Circuit found that plaintiffs had pled a claim of control person liability against JCG under Section 20(a). Noting that a predicate violation of Section 10(b) had already been pled with regard to JCM, the court found that plaintiffs had alleged that JCG exercised the requisite level of control over JCM to satisfy Section 20(a). Specifically, the court noted that plaintiffs' "allegations of complete ownership of JCM by JCG, overlapping management between JCG and JCM, control of JCM by JCG executives, and presumptive authority by JCG to regulate market timing activity in the Janus funds are sufficient to plead a prima facie case of control person liability." Id. at 131.

The Supreme Court granted JCG's and JCM's petition for certiorari and reversed the Fourth Circuit's decision. Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296 (2011). The issue before the Supreme Court was whether JCM could be held liable in a private action under Rule 10b-5 for false statements in the prospectuses for mutual funds advised by JCM. The Supreme Court held that JCM could not be held liable for such statements because it did not *make* the statements.

Mindful that the right of action under Section 10(b) is implied and thus must be interpreted narrowly, see id. at 2301-02, the Court concluded that JCM did not make the statements in question because it was not "the entity with authority over the content of the statement[s] and whether and how to communicate [them]." Id. at 2303. Rather, the Janus Investment Fund—a legally independent entity with its own board of trustees—made the statements at issue. Id. at 2304-05.

e. In Kreek v. Wells Fargo & Co., 652 F. Supp. 2d 1053 (N.D. Cal. 2009), mutual fund investors filed suit under Sections 10(b) and 20(a) of the 1934 Act, claiming that defendants engaged in undisclosed revenue sharing arrangements. The action was a "sequel" to the "heavily litigated" Siemers v. Wells Fargo action.

According to plaintiffs, defendants paid kickbacks to broker-dealers and selling agents to steer clients into defendants' funds, regardless of whether those funds were the best option for investors. Plaintiffs claimed that the kickbacks were financed by hidden fees, the proceeds of which should have been invested in the funds' underlying portfolios. At the outset, Judge Alsup ruled on whether plaintiffs' claims were time-barred. While Judge Alsup found that plaintiffs "were on inquiry notice more than two years before the filing of this action" and that a reasonably diligent investor would have discovered these facts, Judge Alsup found that "the statute of limitations was tolled with respect to the *individual* plaintiffs" because of the filing of the Siemers complaint, "[but not] for the *class* allegations." Id. at 1059-62 (emphases in original). Judge Alsup drew this distinction because "Plaintiffs seek to certify the same class that Siemers had already found inappropriate for certification." Id. at 1061. While Supreme Court precedent extended "tolling to all asserted members of the class who sought to file new but individual actions following a denial of class certification," id. at 1060, extending tolling to the class claims would have resulted in providing the class with "an attempt to relitigate the prior denial of class certification in Siemers." Id. at 1061. Accordingly, while the class claims were dismissed, the individual claims were allowed to proceed.

Judge Alsup also rejected defendants' contention that plaintiffs failed to plead reliance. Id. at 1063. Noting that this case was based on the allegation that defendants omitted material information from its disclosures, the court found that plaintiffs were presumed to have pleaded reliance, per the exception established in Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128 (1972).

f. In Gosselin v. First Trust Advisors, L.P., No. 08 C 5213, 2009 WL 5064295 (N.D. Ill. Dec. 17, 2009), mutual fund investors asserted violations of Sections 11, 12(a)(2), and 15 of the 1933 Act; and Sections 10(b), 14(a), and 20(a) of the 1934 Act, stemming from plaintiffs' investment in mutual funds that had exposure to residential mortgage-backed securities and other "risky" assets. In denying defendants' motion to dismiss, the court first discussed defendants' argument that "Plaintiffs merely contend that Defendants mismanaged the Funds and that [this warrants dismissal] because allegations of corporate mismanagement are not actionable under federal securities laws." Id. at *2. Finding that in addition to claims of poor business judgment "Plaintiffs also contend that Defendants engaged in deception through material misrepresentations and omissions to conceal the ramifications of Defendants' alleged misconduct," the court concluded that

plaintiffs had alleged actionable conduct under the federal securities laws. Id. at *2-3.

With regard to plaintiffs' Section 14(a) and Rule 14a-9 claims, Judge Der-Yeghiayan rejected defendants' argument that plaintiffs' claims were time-barred. While defendants contended that "Plaintiffs were on inquiry notice that the Funds invested in mortgage-related securities and that the Funds were experiencing losses as early as August 2007," the court credited plaintiffs' allegations that defendants "concealed" the impact that "sub-prime mortgages" would have on the funds, and that as a result, plaintiffs did not become aware of their claims until July 2008 when a fund disclosure revealed a substantial decline in that fund's net asset value. Id. at *8. Judge Der-Yeghiayan also noted that "it is generally not appropriate to resolve a statute of limitations issue at the pleadings stage . . . ." Id. at *9.

Finally, with regard to plaintiffs' Section 10(b) claims, defendants sought dismissal on the grounds that since plaintiffs knew of the alleged misrepresentations or omissions in the funds' disclosures, that plaintiffs could not assert that they relied on such statements or omissions when purchasing their shares. Judge Der-Yeghiayan rejected defendants' argument, however, reasoning that plaintiffs were entitled to rely on the "fraud on the market" doctrine because defendants' "misrepresentations or omissions were publicly disseminated" and because plaintiffs purchased their shares in an "open and developed" market. Id. at *9 (citations omitted).

g. In Bachow v. Swank Energy Income Advisers, LP, No. 3:09-CV-262, 2010 WL 70520 (N.D. Tex. Jan. 6, 2010), an investor brought claims under Sections 10(b) and 20(a) of the 1934 Act and Section 36(b) of the Act against the fund's investment adviser, its affiliate, and several adviser executives and fund independent trustees. Plaintiff alleged that defendants misrepresented the fund's investment strategy and holdings, and that when "adverse information [regarding these characteristics] was disclosed to the public," the value of the fund's shares "plummeted." Id. at *1. In denying defendants' motion to dismiss the Section 10(b) claims, the court found that plaintiff had pleaded reliance. Specifically, the court found that plaintiff was entitled to rely on the "fraud on the market" theory because she demonstrated that the "allegedly material misrepresentations or omissions were placed into the mix of market information." Id. at *7.

Finally, the court granted defendants' motion to dismiss with regard to plaintiff's Section 20(a) claim because plaintiff failed to plead that the "controlled persons"—the fund and the investment

adviser—had committed a securities violation. Rather, plaintiff's allegations were only directed towards certain individual defendants. This put an end to the Section 20(a) claim because individuals "cannot be 'control persons' of themselves." Id. at *8-9 (citation omitted).

h. In Cascade Fund, LLP v. Absolute Capital Management Holdings Ltd., 707 F. Supp. 2d 1130 (D. Colo. 2010), individuals and entities that purchased mutual funds managed by defendants alleged that defendants made "misstatements and omissions of material facts in offering memoranda for mutual funds and hedge funds that lost a significant portion of their value when it was revealed that the value of the funds was based on inflated stock prices." Id. at 1134. Plaintiffs claimed defendants' conduct violated Section 10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder.

At the outset, the court dismissed plaintiffs' claims with regard to funds in which they had no investment. Id. at 1137. The court also considered defendants' arguments that plaintiffs' claims should be dismissed for lack of personal jurisdiction and granted defendants' motion as to one of defendants' affiliates and two fund board members. With regard to the affiliate, which was a foreign corporation, the court granted the motion because plaintiffs failed "to demonstrate any purposeful action that [the affiliate] took to direct its business activities at the United States." Id. at 1142. With regard to the board members, who were British citizens residing outside of the United States, the court found that plaintiffs did not allege any purposeful action directed at the United States, and noted that "mere status as a board member is not sufficient to establish jurisdiction. Id. at 1142-43. Finally, while the court ultimately dismissed plaintiffs' claims for failure to plead scienter, id. at 1144, the court found that the adviser defendant, also a foreign corporation, was subject to personal jurisdiction primarily because plaintiffs alleged that the adviser defendant engaged in email correspondence with plaintiffs regarding "fund-related information" as well as the "solicitation of additional investments" from plaintiffs. Id. at 1140-42.

i. In In re Smith Barney Fund Transfer Agent Litigation, No. 05 Civ. 7583, 2012 WL 3339098 (S.D.N.Y. Aug. 15, 2012), plaintiffs alleged that defendants, the investment adviser and two of its officers, recommended that certain Smith Barney funds retain the services of Citicorp Trust Bank ("CTB"), an affiliate of the funds' investment adviser, to serve as the primary transfer agent for the funds. Although CTB was responsible for providing all of the Smith Barney-branded mutual funds' transfer agent services, CTB

allegedly subcontracted the vast majority of the transfer agent work to First Data Investor Services Group ("First Data"). Plaintiffs alleged that pursuant to this subcontract, First Data charged significantly lower fees, yet defendants did not pass on or disclose those discounts to the funds. Id. at *2. Based on these allegations, plaintiffs asserted claims under Sections 10(b) and 20(a) of the 1934 Act, and Rule 10b-5 promulgated thereunder. Plaintiffs' claims were initially dismissed, but the Second Circuit reversed. See Operating Local 649 Annuity Trust v. Smith Barney Fund Management LLC, 595 F.3d 86 (2d Cir. 2010). Plaintiffs' claims then withstood another motion to dismiss before lead plaintiffs' counsel informed the court that the lead plaintiff did not actually own shares in the at-issue funds. See In re Smith Barney Transfer Agent Litig., No. 05 Civ. 7583, 2011 WL 4430857 (S.D.N.Y. Sept. 22, 2011). After plaintiffs resolved the standing issue, plaintiffs re-filed their action, and defendants again moved to dismiss.

The court first determined that plaintiffs' claims were not time-barred. Smith Barney, 2012 WL 3339098, at *6. The court then considered defendants' argument that plaintiffs could not assert a Rule 10b-5(a), (c) claim for "scheme" liability because "the scheme depended on misleading statements, rather than deceptive conduct." Id. The court rejected defendants' argument because defendants "creation of CTB, CTB's subcontracting agreement with First Data, and the subsequent funneling of cost savings away from the Funds were deceptive acts committed in addition to any misleading statements or omissions." Id. at *7.

The court agreed with defendants, however, that "Plaintiffs' allegations of reliance are deficient. Plaintiffs do not invoke the well-recognized Affiliated Ute or 'fraud-on-the-market' reliance presumptions. Nor do they contend that they bought or sold securities in reliance on specific deceptive acts of which they were aware. Rather, they argue that they traded in the Funds' shares in reliance on the assumption that Defendants would honor their fiduciary duties. But this theory of reliance—if accepted—would amount to a novel presumption of reliance in the mutual fund context. And as the Supreme Court has cautioned, any reapportionment of liability in the securities industry in light of the close relationship between investment advisers and mutual funds is properly the responsibility of Congress and not the courts." Id. at *9 (citations omitted). Accordingly, the court dismissed plaintiffs' claims against the investment adviser and one of the two individual defendants, as well as plaintiffs' section 20(a) claim against this individual defendant. Id. at *13.

The court sustained plaintiffs' Rule 10b-5(b) claim against a different individual defendant, however, because that individual defendant signed allegedly misleading prospectuses and other fund documents. The court noted that the individual defendant's "argument is not novel. After [Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296 (2011)], defendants who signed misleading disclosure documents have often contended that only their company or its board of directors—and not they themselves—possessed 'ultimate authority' [over the documents]. But courts in this district and across the country have rejected this argument. Rather, courts consistently hold that signatories of misleading documents 'made' the statements in those documents, and so face liability under Rule 10b–5(b)." Smith Barney, 2012 WL 3339098, at *9.

C. ERISA

As discussed above, plaintiffs have filed numerous lawsuits against some of the nation's largest companies with defined contribution retirement plans, the investment advisers to those plans, and, in some instances, other entities that provided services to the plans. Hoping for the same success defendants had with excessive fee litigation based on revenue sharing under the Act, many defendants have moved to dismiss these cases. The most common arguments advanced by defendants have been that: (1) because disclosure of revenue sharing payments was not required, plaintiffs cannot state a claim for breach of fiduciary duty based on defendants' failure to disclose them; and (2) defendants are protected from any liability by ERISA's safe harbor provision, Section 404(c). In cases where the plan administrator and/or investment provider was named as a defendant, defendants have also argued that the claims against them should be dismissed on the grounds that they are not plan fiduciaries.

While several of defendants' motions have been granted, many have been denied in their entirety or dismissed in part, with the core ERISA claims being allowed to continue.

This Outline generally discusses those actions where investment advisers have been named as defendants.

a. In Haddock v. Nationwide Financial Services, Inc., 419 F. Supp. 2d 156 (D. Conn. 2006), trustees of several different employer-sponsored profit-sharing retirement plans brought a putative class action against Nationwide Financial Services Inc. and Nationwide Life Insurance Co. (collectively, "Nationwide"), which served as the plans' investment provider. As such, Nationwide provided the plans with various investment options, including several mutual funds offered through variable annuities. Plaintiffs alleged that Nationwide had contractual "revenue sharing" arrangements with the funds in the plans in violation of Nationwide's fiduciary duties under ERISA Section 404. Plaintiffs also alleged that these

contracts with the mutual funds constituted prohibited transactions in violation of ERISA Section 406(b), which proscribes fiduciaries from, inter alia, "deal[ing] with the assets of the plan in [their] own interest or for [their] own account" or "receiv[ing] any consideration for their own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan."

Plaintiffs asserted two theories of liability: (1) the fees charged by the mutual funds' investment advisor for investment advisory services and shared with Nationwide constitute plan assets that are not being shared with plan participants; and (2) that Nationwide's contracts with the mutual funds constituted a prohibited quid pro quo arrangement under which it "agree[d] to include . . . funds as investment options . . . in exchange for the revenue sharing payments." Id. at 163-64.

Nationwide filed a motion for summary judgment, arguing that: (1) it was not an ERISA fiduciary, and thus could not be held liable under Sections 404 or 406; (2) the revenue sharing payments did not constitute "Plan assets"; and (3) that their service contracts with mutual funds were not prohibited transactions. The court denied Nationwide's motion in its entirety. See id. at 171-72. Specifically, the court held that, because plaintiffs were able to present evidence that Nationwide exercised control over the selection and offering of the plan's investment options, summary judgment was not proper on the issue of whether Nationwide was a fiduciary for the purposes of ERISA liability. See id. at 166-67. Moreover, the court employed a two-part "functional approach" to determine whether the revenue sharing payments constituted plan assets. Namely, the court held that "'plan assets' include items a defendant holds or receives: (1) as a result of its status as a fiduciary or its exercise of fiduciary discretion or authority, and (2) at the expense of plan participants or beneficiaries." Id. at 170. The court found that plaintiffs had adduced sufficient facts to survive a motion to dismiss. Specifically, plaintiffs provided evidence that "Nationwide receives payments from mutual funds in exchange for offering the funds as an investment option to the plans and participants, e.g., as a result of its fiduciary status or function." Id. at 170. And even though the court found that plaintiffs had not set forth any facts that would demonstrate that these revenue sharing payments led to increased mutual fund fees borne by plan participants, it held that, because "Nationwide's motion is almost entirely based on questions of law" it would allow the claim to proceed. Id. at 171. Finally, the court also held that, viewing the evidence in the light most favorable to plaintiffs, their claim regarding service contracts also survived summary

judgment since "a reasonable fact-finder could conclude that Nationwide received consideration (i.e., revenue sharing payments) from a party dealing with the plans (i.e., the mutual funds whose shares are available for investment by the plans and participants) in connection with a transaction (i.e., the so-called service contracts) involving assets of the plan (i.e., the shares of the variable accounts)." Id.

On November 6, 2009, Judge Underhill granted plaintiffs' motion for class certification. See Haddock v. Nationwide Fin. Servs. Inc., 262 F.R.D. 97 (D. Conn. 2009). Judge Underhill subsequently denied defendants' motion to certify the existing class as a class for defendants' counterclaim. See Haddock v. Nationwide Fin. Servs. Inc., 272 F.R.D. 61 (D. Conn. 2010). On February 6, 2012, the Second Circuit vacated the district court's order regarding class certification, and remanded the case for reconsideration in light of the Supreme Court's decision in Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541 (2011). See Haddock v. Nationwide Fin. Servs. Inc., 460 F. App'x 26, 29 (2d Cir. 2012). On September 6, 2013, the district court granted plaintiffs' renewed motion for class certification. Haddock v. Nationwide Fin. Servs. Inc., No. 01-cv-1552, 2013 WL 4782375 (D. Conn. Sept. 6, 2013). On January 5, 2015, the district court preliminarily approved a stipulated settlement between the parties.

b. In Kanawi v. Bechtel Corp., No. 06-cv-5566, 2007 U.S. Dist. LEXIS 97994 (N.D. Cal. May 15, 2007), plaintiffs alleged that the Bechtel Corporation ("Bechtel"), which established Bechtel's 401(k) plan; the Bechtel Trust and Thrift Plan Administrative Committee, a committee appointed by Bechtel to administer the plan; and Peggi Knox, the Vice President of retirement plans at Bechtel, breached their fiduciary duties under ERISA by causing plan participants to incur unreasonable and excessive fees. Plaintiffs further alleged that defendants either disguised certain fees incurred by the participants or failed to disclose certain fees.

Defendants moved to dismiss the complaint. Defendants argued that: (1) the complaint failed to allege any violation of applicable statutes or regulations regarding fee disclosure; (2) they were protected from liability by ERISA's safe harbor provision, Section 404(c); and (3) Bechtel was not a fiduciary of the plan because it did not render any authority or control with respect to the management or disposition of the plan's assets. See id. at *6.

The court disagreed with defendants' arguments and sustained plaintiffs' complaint. First, the court rejected defendants' argument that they had met their disclosure obligations under

ERISA, noting that "[t]he Supreme Court and the Ninth Circuit have explicitly stated that mere compliance with applicable statutes and regulations under ERISA is not sufficient to establish that a fiduciary has satisfied its obligations." Id. at *6-7. Similarly, the court rejected defendants' reliance on ERISA Section 404(c), calling defendants' argument "premature" because "[i]t is not possible to determine, at the pleading stage, whether Defendants' conduct falls within ERISA's safe harbor provision. Such a determination hinges against the 'beneficiary's exercise of control,' an issue that is called into question by the disclosures, or more precisely by the alleged lack of disclosures, that Defendants provided to participants in the Plan." Id. at *8-9. Additionally, with respect to defendants' argument that Bechtel was not a fiduciary, the court stated that despite the complaint's failure to allege that Bechtel either rendered investment advice or exercised control over the plan, it was unable to conclude that plaintiffs could not prove any set of facts demonstrating that Bechtel enjoyed some sort of control over the management of the plan. See id. at *10-13.

Following discovery, the parties moved for summary judgment. On November 3, 2008, Judge Breyer granted in part and denied in part Bechtel's motion for summary judgment, and denied plaintiffs' motion for summary judgment in toto. See Kanawi v. Bechtel Corp., 590 F. Supp. 2d 1213 (N.D. Cal. 2008). Importantly, Judge Breyer held that Bechtel did not have any fiduciary responsibility with respect to the administration or investment management of the plan, and thus its liability was limited to joint liability for breaches of co-fiduciaries under Section 1105(a). See id. at 1224. The court found that Bechtel had delegated its responsibilities to the Plan Administrative Committee and the affiliated investment adviser. See id. Additionally, the court granted Bechtel's motion for summary judgment with respect to plaintiffs' claims that defendants had engaged in prohibited transactions by selecting an affiliated investment adviser to manage the plan for the time period that Bechtel paid the plan's administrative fees. See id. at 1227-28. For the brief period when those fees were paid by the plan participants, the court held that a genuine issue of material fact existed as to whether the arrangement constituted self-dealing in violation of ERISA Section 406. See id.

Judge Breyer also granted defendants' motion for summary judgment with respect to plaintiffs' claims that the management fees paid by defendants to affiliated mutual funds available under the plan constituted a breach of loyalty and/or an imprudent investment. The court held that defendants acted prudently, and

separately found that plaintiffs had not demonstrated that defendants' conduct fell outside their obligations to plan participants. See id. at 1230. Similarly, the court also granted defendants' motion for summary judgment with respect to plaintiffs' claims that defendants breached their fiduciary duties by: (1) the investment adviser charging a fee for additional services to plan participants; and (2) not sharing the profits from the sale of the investment adviser with plan participants. See id. at 1230-31.

For plaintiffs' surviving claims, the court held that defendants were not entitled to summary judgment based on ERISA's safe harbor provision, as there were still material questions of fact concerning whether plaintiffs were able to exercise control over the assets in their accounts. See id. at 1231-32. The court otherwise limited plaintiffs' recovery based on ERISA's 6-year statute of limitations. See id. at 1226.

c. In Hecker v. Deere & Co., 496 F. Supp. 2d 967 (W.D. Wis. 2007), plaintiffs purported to bring a class action against defendants Deere & Co. ("Deere"), the sponsor and administrator of Deere's 401(k) plan; Fidelity Management and Trust Company ("FMTC"), the plan's trustee; and Fidelity Management and Research Company ("FMRCo"), the investment adviser to the funds under the plan. Plaintiffs alleged that defendants violated their fiduciary duties under ERISA by: (1) by providing investment options with excessive and unreasonable fees and costs; and (2) by failing to adequately disclose information about revenue sharing payments made by FMRCo to FMTC. See id. at 971. Each defendant moved to dismiss the complaint. Deere argued that: (1) its disclosure of the plan fees complied with ERISA; and (2) ERISA's safe harbor provision barred any claim based on the amount of such fees. See id. FMTC argued that, although it had some fiduciary duties to plaintiffs, plaintiffs' claims did not relate to its role as a fiduciary. See id. FMRCo argued that it was not a fiduciary under ERISA. See id.

The court agreed with defendants' arguments and dismissed the complaint, with prejudice, in its entirety. See id. at 977. First, the court held that defendants were not responsible for disclosing that FMRCo shared part of its fees with FMTC because neither the current ERISA regulations nor ERISA's general fiduciary requirements impose a duty to disclose revenue sharing payments. See id. at 974. Second, the court held that ERISA's safe harbor provision protected defendants from liability "because of the nature and breadth of funds made available to participants under the plans." Id. at 976. Thus, any loss plaintiffs suffered was a result of their personal investment choices. See id. Finally, the

court held that neither FMTC or FMRCo "had fiduciary responsibility for making plan disclosures or selecting plan investments" and therefore could not be held liable. Id.

The Seventh Circuit affirmed the district court's dismissal. See Hecker v. Deere & Co., 556 F.3d 575 (7th Cir. 2009). On appeal, plaintiffs argued that the district court erred in not finding that the Fidelity entities were fiduciaries under the plan because they exercised some discretionary authority in the selection of investment options for the plan, and because they exercised discretion over the disposition of the plan's assets by determining how much revenue FMRCo would share with FMTC. Id. at 583-84. The Seventh Circuit rejected plaintiffs' arguments, holding that, even though FMTC "play[ed] a role" in selecting the investments under the plan, Deere ultimately held responsibility for approving FMTC's recommendations. Id. Additionally, the court held that the fees collected by FMRCo for providing investment management services to the funds were not plan assets, but FMRCo's assets, and thus their use of those revenues did not cause either of the Fidelity entities to become a fiduciary under ERISA. See id.

The Seventh Circuit also held that plaintiffs failed to sufficiently plead a breach of fiduciary duty cause of action against Deere. See id. at 584-87. With respect to plaintiffs' claim that Deere breached its fiduciary duty by failing to disclose the "revenue sharing" payments between FMRCo and FMTC, the court held that "Deere disclosed to the participants the total fees for the funds and directed participants to the fund prospectuses for information about the fund-level expenses," and that such disclosures "w[ere] enough" to satisfy its fiduciary duties under ERISA. Id. at 586. The court held that "[h]ow [FMRCo] decided to allocate the monies it collected" was not "something that had to be disclosed." Id. at 585. In addition, the Seventh Circuit held that plaintiffs' contention that Deere breached its fiduciary duties by selecting investments with excessive fees to be without merit. See id. at 586. The court found that "no rational trier of fact could find, on the basis of the facts alleged in this Complaint, that Deere failed to satisfy [its] duty [to furnish an acceptable array of investment vehicles]," given that the plan offered 26 different investment options, including 23 retail mutual funds, as well as over 2,500 funds through a separate facility operated by Fidelity. Id.

Alternatively, the Seventh Circuit also held that, even if plaintiffs had alleged a proper cause of action against Deere, plaintiffs' claims were properly dismissed pursuant to the ERISA safe harbor provision. See id. at 587-90. The Seventh Circuit found that,

because it is an affirmative defense, it would be generally improper to dismiss a complaint based on the safe harbor provision. See id. at 588. However, the court held that plaintiffs had "so thoroughly anticipated the safe-harbor defense [in their complaint] that it could reach the issue" of whether it warranted dismissal. Id. After again emphasizing that the plan offered participants thousands of investment options, the Seventh Circuit held that "[a]ny allegation that these options did not provide the participants with a reasonable opportunity to accomplish the . . . goals outlined in the regulation . . . is implausible. . . . Given the numerous investment options . . . neither Deere nor Fidelity . . . can be held responsible for [the plan participants'] choices." Id. at 590.

Plaintiffs subsequently filed a petition for panel rehearing and a petition for rehearing en banc. See Hecker v. Deere & Co., 569 F.3d 708 (7th Cir. 2009). The Seventh Circuit denied both petitions. Finally, the Supreme Court denied plaintiffs' petition for writ of certiorari. See Hecker v. Deere & Co., 130 S. Ct. 1141 (2010).

d. In Beary v. Nationwide Life Insurance Co., No. 2:06-CV-967, 2007 WL 4643323 (S.D. Ohio Sept. 17, 2007), the same plaintiff's counsel as in the Haddock action, supra, filed a purported class action against various Nationwide entities asserting essentially identical factual allegations as those contained in Haddock. This action, however, alleged claims of common law breach of fiduciary duty and unjust enrichment, rather than violations of ERISA. See id. at *1-2. Defendants moved to dismiss the complaint, arguing that the case was preempted by SLUSA because it was a "covered class action." Id. at *2. The court agreed. Specifically, the court held that the complaint alleged untrue statements or omissions of material fact since "the substance of Plaintiff's claim is that Nationwide misrepresented a relationship with Investment Advisors or, at a minimum, omitted to disclose material facts about the relationship." Id. at *4. Similarly, the court found that the alleged misrepresentation or omission "coincided" with the purchase or sale of mutual fund shares by plan participants, and thus, following the Supreme Court's precedent in Dabit, plaintiff's allegations were "in connection with the purchase or sale of securities." Id.

e. In Charters v. John Hancock Life Insurance Co., 534 F. Supp. 2d 168 (D. Mass. 2007), a trustee of the plan for Charters, Heck, O'Donnell & Petrulis P.C., a personal injury law firm, brought suit on behalf of the plan and all trustees, sponsors, and administrators under ERISA that owned variable annuity contracts from John Hancock Life Insurance Company ("Hancock"), against, Hancock,

which performed investment and administrative services for the plan. Under the terms of the plan's contract with Hancock, defendant established, maintained, and had the right to substitute investment options under the plan. See id. at 169-170. Plaintiff alleged that Hancock violated various ERISA provisions by breaching its fiduciary duties and committing prohibited transactions by charging excessive fees and retaining revenue sharing payments from the mutual funds it offered under the plan. See id. at 170. Defendant moved to dismiss, arguing that: (1) they were not plan fiduciaries; and (2) Charters only had standing to assert certain claims in the complaint. See id. at 171.

The court denied defendant's motion to dismiss in its entirety. The court found that the degree to which Hancock could choose and modify the investment options under the plan was unclear, and, citing Haddock v. Nationwide Fin. Servs., held that it could not decide whether Hancock was an ERISA fiduciary at the pleading stage. See id. at 171-72. The court also held that Hancock's standing argument was without merit, except that it found that Charters could not represent plan sponsors, which do not have a right of action under ERISA. See id. at 172-73.

On September 30, 2008, Judge Gorton held that Hancock was a plan fiduciary, granting plaintiff's partial motion for summary judgment on the issue. See Charters v. John Hancock Life Ins. Co., 583 F. Supp. 2d 189, 197-199 (D. Mass. 2008). The court held that Hancock was a fiduciary for two reasons. First, the court held that Hancock "had the sole authority" to set the administrative service fees charged to plan participants, since it was only limited "by a maximum charge" and could, in fact, change this maximum charge at any time upon three months' notice. See id. at 198. Second, the court found that Hancock's ability to substitute investment options under the plan "rendered it a fiduciary under the plan." Id. at 199. The court rejected Hancock's argument that its discretion to replace investment options was actually limited because Charters could refuse Hancock's proposed substitutions. See id. at 198-99. The court held that the penalties built into Hancock's contract with the plan that would follow from Charters rejecting any such substitution did not provide plaintiff "a meaningful opportunity" to actually reject any substitutions. Id. at 199.

In its September 30, 2008, ruling, the court also denied Hancock's cross-motion for summary judgment, finding that there were questions of fact as to whether Hancock breached its fiduciary duties. See id. at 199. Specifically, the court disagreed with Hancock's contention that its fees were not excessive, as a matter

of law, because they were fully disclosed. The court also found that the evidence in the record did not support Hancock's contention that there were no issues of material fact with respect to whether the revenue sharing payments were applied exclusively to offset the plan's administrative fees. See id. at 199-200.

f. In Young v. General Motors Investment Management Corp., 550 F. Supp. 2d 416 (S.D.N.Y. 2008), participants in four separate defined contribution plans established by General Motors brought suit against General Motors Investment Management Corporation and State Street Bank & Trust & Company, the plans' service providers and trustees. See id. at 418. Plaintiffs' primary allegations were that defendants breached their fiduciary duties under ERISA by imprudently selecting investment options for the plans. See id. According to plaintiffs, defendants should not have offered either: (1) funds that only held single equities, since these funds were not diversified, and thus, exposed plan participants to undue risk; or (2) mutual funds sponsored by Fidelity, since these funds "carried fees in excess of similar investment products available to large, institutional investors" causing the plans to incur excessive investment advisory fees. See id. The district court held that plaintiffs' claims were barred in their entirety by ERISA's statute of limitations, since plaintiffs had actual knowledge of the challenged products' investment guidelines and fees more than three years prior to the filing of the suit. See id. at 420.

The Second Circuit affirmed the district court's dismissal, albeit not on statute of limitations grounds. Rather, the Second Circuit held that plaintiffs had failed to state a claim upon which relief could be granted. See Young v. Gen. Motors Inv. Mgmt. Corp., 325 F. App'x 31 (2d Cir. 2009). Specifically, the court held that ERISA only required a fiduciary to diversify the investments *of a plan*, but did not demand that *each* investment option be itself diversified. See id. at 33. Thus, "[t]he complaint's narrow focus on a few individual funds, rather than the plan as a whole, is insufficient to state a claim for lack of diversification." Id. Additionally, the Second Circuit found that plaintiffs had not alleged any facts that would support a claim that the fees of the Fidelity funds were excessive "relative to the services rendered." See id. (citing Gartenberg v. Merrill Lynch Asset Mgmt., 694 F.2d 923, 928 (2d Cir. 1982)). As such, the court held that plaintiffs failed to state a claim that the Fidelity funds were imprudent investments because their fees were excessive. See id.

g. In Martin v. Caterpillar, Inc., No. 07-cv-1009, 2008 WL 5082981 (C.D. Ill. Sept. 25, 2008), participants in Caterpillar's 401(k) plan sued Caterpillar, its Benefit Funds Committee, and Caterpillar

Investment Management, a wholly owned subsidiary of Caterpillar which acts as the plan's investment adviser. See id. at *1. Under the plan, participants could select 17 preferred groups of mutual funds sponsored by an affiliated Caterpillar entity. See id. Plaintiffs brought action under ERISA, alleging that defendants breached their fiduciary duties by, inter alia, charging plan participants excessive fees, collecting fees to manage the funds available under the plan, collecting other "revenue sharing" fees in connection with sponsoring the plan, failing to disclose these "revenue sharing" payments, and selecting improper investment options for the plan. See id. The court dismissed plaintiffs' disclosure claims, holding that defendants had no duty under ERISA to disclose revenue sharing arrangements. See id. at *4. With respect to plaintiffs' other claims, the court rejected defendants' argument that they should be barred pursuant to ERISA's safe harbor provision, Section 404(c). See id. at *5. The court found that, because Section 404(c) was an affirmative defense, it was inappropriate to rule on its applicability on a motion to dismiss and that, nevertheless, defendants had not proven that plaintiffs exercised the control contemplated by Section 404(c). See id. This matter has since been settled (with final approval of the court). See Martin v. Caterpillar, Inc., No. 07-CV-1009, 2010 WL 3210448 (C.D. Ill. Aug. 12, 2010).

h. In In re Honda of Am. Mfg., Inc. ERISA Fees Litig., No. 2:08-cv-1059, 2009 WL 3294828 (S.D. Ohio Oct. 13, 2009), participants in Honda's 401(k) plan sued Honda, several of its executives, and Merrill Lynch Bank & Trust ("Merrill"), alleging that defendants breached their fiduciary duties in charging, or allowing Merrill to charge, excessive fees, as well as fees that were not incurred for the benefit of plan participants. The Honda defendants and the Merrill defendants filed separate motions to dismiss the complaint, and the court granted both motions on the grounds that plaintiffs "failed to state plausible claims for relief." Id. at *2. Accordingly, the court did not consider Merrill's argument that the claims against it should be dismissed because it was not a fiduciary to plaintiffs under ERISA. Id. Rather, the court followed the Seventh Circuit's decision in Hecker v. Deere & Co., 556 F.3d 575 (7th Cir. 2009), in finding that plaintiffs' allegations regarding the types of funds offered in the plan did not state a claim, as there is nothing in ERISA that "requires plan fiduciaries to include any particular mix of investment vehicles in their plan." See In re Honda of Am. Mfg., Inc. ERISA Fees Litig., 661 F. Supp. 2d 861, 866-67 (S.D. Ohio 2009). Further, the court followed Hecker in concluding "that nothing in ERISA requires . . . Defendants to search the market to find and offer the cheapest possible fund." Id. at 867.

The court also held that plaintiffs' allegations that defendants engaged in "undisclosed self-dealing by offering and charging multiple layers of excessive fees," did not state a claim under ERISA. Id. at 868 (citation omitted). Since ERISA requires plaintiffs to identify a specific prohibited transaction, the court dismissed plaintiffs' claim because "a conclusory allegation of undisclosed self-dealing is insufficient to plausibly suggest any violation of Section 406(b)(1)." Id. at 869 (citation omitted). Finally, the court rejected plaintiffs' contention that defendants should have provided additional disclosures regarding the inclusion of Merrill related funds in the plan, even when ERISA's detailed disclosure provisions did not require it because "this Court is prohibited from relying on other ERISA provisions to create implied disclosure obligations." Id. at 870.

i. In Gipson v. Wells Fargo & Co., No. 08-4546, 2009 WL 702004 (D. Minn. Mar. 13, 2009), participants in Wells Fargo's 401(k) plan brought suit claiming that Wells Fargo violated ERISA by allowing the plan to invest in mutual funds managed by Wells Fargo's affiliate, Wells Fargo Fund Management ("WFFM"). See id. at *1. Defendants moved to dismiss the complaint in its entirety. While the court did dismiss on standing grounds the claims brought by a former employee who, as a result, was no longer a participant in the plan, see id. at *2, the court denied defendants' motion in all other respects.

First, the court held that plaintiffs' allegation that defendants "invested in a category of stock that generated higher fees for WFFM, rather than in the 'institutional' category" was sufficient to plead a claim for a prohibited transaction involving self-dealing. The court also declined to dismiss this claim on statute of limitations grounds, as it was not clear "whether and when" plaintiffs received disclosures that would have placed them on sufficient inquiry notice. See id. at *4-5. The court also held that plaintiffs had pled various breach of fiduciary duty claims against defendants on the basis that: (1) "the plan invested in a class of shares with higher administrative fees when a cheaper class of shares was available"; (2) the performance of the plans was "sub-par"; and (3) the plan's assets were "seed money" used to allow "the funds to survive and to attract other investors . . . ." Id. at *5.

j. In Montoya v. ING Life Insurance & Annuity Co., 653 F. Supp. 2d 344 (S.D.N.Y. 2009), participants in a school district plan that purchased annuities from ING Life Insurance and Annuity Company ("ING"), on a tax-deferred basis, brought suit against New York State United Teachers ("NYSUT"), the plan trustee, the NYSUT Member Benefits Trust, various NYSUT trustees, and

ING. Plaintiffs alleged that defendants were liable under ERISA because they endorsed ING's plan in exchange for receiving kickback payments from ING. In granting defendants' motion to dismiss, the court found that the plan was a "governmental plan," and as such, was exempt from liability under ERISA. See id. at 350-52. In coming to this conclusion, the court emphasized that the plan was "established or maintained" by a school district, and that the school district was the "sole source of funding" for the plan. See id.

k. In Columbia Air Services, Inc. v. Fidelity Management Trust Co., No. 07-11344, 2008 WL 4457861 (D. Mass. Sept. 30, 2008), the sponsor and administrator for the Columbia Group of Companies 401(k) Retirement Services Plan ("Columbia") brought suit against Fidelity Management Trust Company ("FMTC") alleging that FMTC breached its fiduciary duty under ERISA by receiving a share of the fees paid to various Fidelity mutual funds while providing no additional services. See id. at *1-2. FMTC moved to dismiss Columbia's claims on the grounds that it was not an ERISA fiduciary, as "FMTC contracted only to provide certain administrative services. . . ." Id. at 3. The court granted FMTC's motion because Columbia failed to allege "specific facts indicating that FMTC exercised discretionary authority with respect to any transaction that led to its alleged receipt of improper compensation." Id. Further, the court noted that it "would be a different story if FMTC had directed the plan's investments to mutual funds that in turn paid it for doing so. But here it is clear that the selection of the mutual funds was done by Columbia []." Id. at *4.

l. In Ruppert v. Principal Life Insurance Co., No. 4:07-cv-344, 2010 WL 6794683 (S.D. Iowa Mar. 31, 2010), a trustee for Fairmount Park, Inc. Retirement Savings Plan brought suit against the Principal Life Insurance Company ("Principal") for breaching its fiduciary duty under ERISA. Plaintiff alleged that Principal failed to disclose the existence of revenue sharing agreements with the mutual funds included in Principal's pre-packaged 401(k) plans. While Judge Jarvey initially dismissed plaintiff's claims on the pleadings, see Ruppert v. Principal Life Insurance Co., No. 4:07-cv-344, 2009 WL 5667708 (S.D. Iowa Nov. 5, 2009), following the Eighth Circuit's decision in Braden v. Wal-Mart Stores, Inc., 588 F.3d 585 (8th Cir. 2009), Judge Jarvey granted plaintiff's motion for reconsideration. See Ruppert, 2010 WL 6794683 at *1.

With regard to plaintiff's breach of fiduciary duty claim, the court found that under Braden, plaintiff had stated a claim by alleging that Principal selected mutual funds that engage in revenue sharing

where the "kickbacks" are not returned to the plan. See id. at *7. Notably, Judge Jarvey wrote that to "satisfy the Rule 8 pleading requirements, [plaintiff] must only allege the amount, the retention of the fees without credit to the plan, and that payments were made for inclusion in the fund. This is material information in a revenue sharing claim and because it is a fact-intensive issue, the Court cannot conclude that no reasonable juror would not want disclosure on revenue sharing payments when making an investment decision." Id. at *8 (citation omitted).

Judge Jarvey also granted plaintiff's motion for reconsideration with regard to the prohibited transaction claim. Specifically, the court found that since Principal was alleged to have "dealt with assets of the plan for its own account or received consideration from another party through revenue sharing payments, it engaged in a prohibited transaction. Thus, following Braden, the Court finds that the burden of proof is on Principal to assert a § 1108 defense." Id. at *12 (footnote omitted).

m. In Leimkuehler v. American United Life Insurance Co., 752 F. Supp. 2d 974 (S.D. Ind. 2010), a trustee for the Leimkuehler, Inc. Profit Sharing Plan (the "Plan") brought suit against the American United Life Insurance Company ("American United") for breaching its fiduciary duty under ERISA. Plaintiff alleged that American United failed to disclose the existence of revenue sharing agreements with the mutual funds included in the Plan, and in doing so, committed several ERISA violations. Id. at 977-79. At the outset, American United moved to dismiss the trustee's claims on the grounds that it owed no duty of disclosure to the trustee. While defendant sought to rely on Hecker v. John Deere & Co., 556 F.3d 575 (7th Cir. 2009), the court denied defendant's motion noting that defendant's status as a plan fiduciary distinguished Hecker from the case at bar. The court also ruled that American United's status as a fiduciary made its receipt of revenue sharing payments a possible basis for liability. See Leimkuehler, 752 F. Supp. 2d at 982-85.

The court came to two conclusions regarding the trustee's prohibited transaction claims. While the court dismissed the claim that American United violated § 1106(b)(1), the court sustained the trustee's § 1106(b)(3) claim, as while "Hecker may conclusively establish that shared revenue is not a plan asset, the opinion does not address whether shared revenue can be deemed the type of consideration 'from a party dealing with the plan in connection with a transaction involving assets of the plan.'" Id. at 987 (quoting 29 U.S.C. § 1106(b)(3)). Accordingly, citing the undeveloped record, the court found that a motion to dismiss was

not warranted regarding the § 1106(b)(3) claim. See Leimkuehler, 752 F. Supp. 2d at 987.

Finally, the court dismissed the trustee's claims that American United was liable as a non-fiduciary. First, the court rejected the trustee's claim that the nondisclosure of the revenue sharing payments prevented him from defraying reasonable expenses involved with the Plan, as the trustee "provided no legal authority . . . subjecting non-fiduciary third parties to liability if they fail to disclose information that would facilitate a fiduciary's fulfillment of his fiduciary duties." Id. Second, the court dismissed the trustee's prohibited transaction claim because "there are insufficient facts pled to state a plausible claim that [American United] took shared revenue from plan assets in its separate accounts." Id. at 988.

The Seventh Circuit affirmed the district court's judgment in April 2013, stating that "we agree with the district court that AUL is not acting as a fiduciary for purposes of 29 U.S.C. 1002(21)(A) when it makes decisions about, or engages in, revenue sharing." Leimkuehler v. Am. United Life Ins. Co., 713 F.3d 905 (7th Cir. 2013).

n. In Pfeil v. State Street Bank & Trust Co., No. 09-CV-12229, 2010 WL 3937165 (E.D. Mich. Sept. 30, 2010), participants in GM's two main 401(k) plans brought suit against the investment manager for the plans "for failure to prudently manage the Plans' assets, in violation of Section 404 of ERISA." Id. at *1.

Specifically, plaintiffs took issue with State Street's management of the GM employee stock ownership plan ("ESOP"). The 401(k) plan required State Street to offer the ESOP, without regard to diversification concerns, the risk profile of GM stock, the income provided by GM stock, or the fluctuation in the fair market value of GM stock, "unless State Street, using an abuse of discretion standard, determines from reliable public information that: (1) there is a serious question concerning the Company's short-term viability as a going concern without resort to bankruptcy proceedings; or (2) there is no possibility in the short-term of recouping any substantial proceeds form the sale of stock in bankruptcy proceedings." Id. at *2.

Plaintiffs alleged that State Street violated its duties by continuing to offer the ESOP even though it was aware of "red flags clearly indicating that GM stock was an imprudent investment causing the people who rely on the assets in the Plans to fund their retirement, to suffer . . . losses." Id. (citation omitted). While the court found

that plaintiffs alleged "sufficient 'red flags' that should have placed State Street on notice of a need to cease offering GM stock to Plan participants or to liquidate the ESOP funds," the court granted State Street's motion to dismiss because plaintiffs failed to show that State Street caused plaintiffs' losses. See id. at *5. The court based its decision on the fact that plaintiffs at all times had the ability to "change the allocation of the assets from one [fund] to another on any business day." Id. at *6. Accordingly, since "Plaintiffs had knowledge at the time State Street became the fiduciary, that GM was in financial trouble yet they continued to invest in the ESOP . . . , State Street cannot be held liable for actions which Plaintiffs controlled." Id.

o. In Kenney v. State Street Corp., 754 F. Supp. 2d 288 (D. Mass. 2010), a former State Street employee who participated in State Street's retirement plan brought suit alleging that "State Street imprudently invested Plan funds in State Street Stock and made negligent misrepresentations that concealed the risks posed by the various financial instruments held by the Plan." Id. at 289-90. While the court had previously dismissed several of plaintiff's ERISA claims, see Kenney v. State Street Corp., 694 F. Supp. 2d 67 (D. Mass. 2010), one negligent representation claim remained.

While the court found that State Street had issued a misleading press release as to the state of its investment portfolio, the court still dismissed plaintiff's claim. The court reasoned that since plaintiff admitted at his deposition that he had not read the press release, and thus could not have relied on it, plaintiff's negligent misrepresentation claim failed as a matter of law. Id. at 291. The court also stated that it did not matter that plaintiff was seeking relief for an entire class of beneficiaries, as "named plaintiffs in a class action must be able to make out an individual claim." Id. at 292 (citation omitted). Finally, the court denied plaintiff's effort to avoid the issue by turning what was surely an affirmative misrepresentation claim into one for nondisclosure. See id.

p. In Santomenno v. John Hancock Life Insurance Co., 2:10-cv-1655, 2011 WL 2038769 (D.N.J. May 23, 2011), plaintiffs purported to bring a class action against several John Hancock entities which served as administrator, investment adviser and distributor to the plan. Plaintiffs alleged that defendants violated their fiduciary duties under ERISA by: (1) charging excessive management fees; (2) violating Rule 12b-1; (3) receiving wrongful revenue sharing payments; and (4) selecting poor investment options. See id. at *1-2. Defendants moved to dismiss and argued that since plaintiffs' claims were derivative in nature, plaintiffs erred in not making a pre-suit demand on the plans' trustees. See id. at *2.

While the court noted that the Third Circuit was silent as to whether demand applies in an ERISA action, the court followed persuasive authority from the Second Circuit, the common law of trusts, as well state law from where the plan was organized (Michigan), to find that the demand issue was applicable. See id. at *3 (citing Diduck v. Kaszycki & Sons Contractors, Inc., 873 F.2d 912, 916 (2d Cir. 1989)). Accordingly, the court dismissed plaintiffs' claim for failure to make a demand (or allege demand futility), or to join the plan's trustees. Id. at *4 (citations omitted).

On appeal, the Third Circuit vacated the district court's ruling, and held that "the language of the statute, the legislative history, and the structure of this remedial legislation compel the conclusion that neither a pre-suit demand requirement nor joinder of the plan trustees is a prerequisite to Participants' claims." Santomenno v. John Hancock Life Insurance Co., 677 F.3d 178, 189 (3d Cir. 2012).

Once the action was remanded, the district court granted defendants' motion to dismiss. Citing to the Third Circuit's decision in Renfro v. Unisys Corp., 671 F.3d 314 (3d Cir. 2011), the court first held that John Hancock was not a fiduciary with respect to its fees. Santomenno v. John Hancock, No. 10-cv-1655, 2013 WL 3864395, *7 (D.N.J. July 24, 2013). Second, the court held that John Hancock was not a fiduciary with respect to revenue-sharing payments, as "[s]ervice providers do not 'become fiduciaries merely by receiving shared revenue,' especially when 'the total expense of the investment was accurately disclosed' to plan participants." Id. (quoting Leimkuehler v. Am. United Life Ins. Co., No. 10-333, 2012 WL 28608, at *14 (S.D. Ind. Jan. 5, 2012), aff'd, 713 F.3d 905 (7th Cir. 2013)). Third, the court held that John Hancock's selection of a particular investment option did not create fiduciary status, as the plan trustees, and not John Hancock, had the final say in the options included in the plans.

The court also rejected arguments that John Hancock was a fiduciary because it maintained assets in a separate account, reserved the right to change funds in the plans, and provided investment advice, as none of those acts related to any alleged breach of fiduciary duty. Finally, the court rejected the argument, as did the Third Circuit in Renfro, that 401(k) service providers are ERISA fiduciaries.

On appeal, the Third Circuit affirmed the district court's dismissal, and held that plaintiffs failed to plead that John Hancock was a fiduciary under ERISA. Santomenno v. John Hancock Life Ins. Co., 768 F.3d 284, 300 (3d Cir. 2014). Plaintiffs contended that

John Hancock acted as a fiduciary under ERISA by: (1) exercising discretionary authority with respect to the management of the plans, and (2) rendering investment advice to the plans. Id. at 292. Notably, plaintiffs' appeal was limited to their claim that John Hancock violated its fiduciary duty by charging excessive fees. Id.

Regarding their first contention, plaintiffs alleged that John Hancock exercised discretionary authority by selecting investment options, monitoring the performance of those options, and retaining authority to change those options and alter its fees. Id. at 295. The court held that these actions did not establish that John Hancock exercised discretionary authority with respect to the management of the plans under ERISA. Id. at 297. The court explained that prior precedent, including Renfro and Leimkuehler, established that the selection of investment options does not make John Hancock a fiduciary and noted that the trustees exercised final authority over the investment options. Id. at 295. With respect to monitoring the performance of those options, the court found that this activity does not give John Hancock discretionary authority "over anything, much less the management of the plans." Id. at 296. The court further found that John Hancock's retention of authority to change investment options and alter its fees lacked a nexus with the wrongdoing alleged in plaintiffs' complaint (*i.e.*, charging excessive fees). Id. Furthermore, even if a nexus existed, the court noted that ultimate authority still resided with the trustees, who had the choice whether to accept or reject John Hancock's changes. Id. at 297.

Regarding plaintiffs' second contention, the court held that John Hancock's purported rendering of investment advice had no nexus with the wrongdoing alleged in plaintiffs' complaint. Id. at 297. Even if a nexus existed, the court found that plaintiffs had failed to plead that John Hancock was an investment advice fiduciary under ERISA. Id. The court stated that an entity is an investment advice fiduciary if it, among other things, "rendered investment advice to the plans pursuant to a mutual agreement, arrangement or understanding." Id. at 299 (citation and internal quotation marks omitted). Here, the contracts between the plans and John Hancock expressly disclaimed taking on any fiduciary relationship, and thus, the court found that no mutual assent to an advisory relationship existed. Id.

q. In Renfro v. Unisys Corp., 671 F.3d 314 (3d Cir. 2011), the Third Circuit affirmed a district court decision, see No. 07-2098, 2010 WL 1688540 (E.D. Pa. Apr. 26, 2010), dismissing several ERISA claims brought against the company and various Fidelity affiliates that served as the plan's investment adviser and administrator.

Plaintiffs alleged that defendants charged plan participants excessive administrative and investment management fees by failing to leverage the plan's large size to negotiate lower fees or increased services for the plan. Renfro, 671 F.3d at 319.

The Third Circuit first affirmed the district court's ruling that Fidelity was not a fiduciary with respect to the selection of investment options. Central to the court's analysis was the fact that the trust agreement specifically stated that Fidelity had no authority to control which investment options were to be part of the plan. See id. at 323.

With regard to plaintiffs' claims that Fidelity was liable as a co-fiduciary for the company's breaches of ERISA, the Third Circuit began its analysis by quoting Hecker in stating that a party "does not act as a fiduciary with respect to the terms in the service agreement if it does not control the named fiduciary's negotiation and approval of those terms." Id. at 324 (citing Hecker v. Deere & Co., 556 F.3d 575, 583 (7th Cir. 2009)). The court then cited plaintiffs' allegation that the company actually negotiated with Fidelity over fees to conclude that Fidelity could owe "no fiduciary duty with respect to the negotiation of its fee compensation by Unisys. Moreover, Fidelity was not yet a plan fiduciary at the time it negotiated the fee compensation with Unisys." Id.

The Third Circuit completed its analysis of the claims against the Fidelity defendants by affirming the district court's dismissal of plaintiffs' claim for restitution. The court reasoned that since "the Fidelity entities did not act as fiduciaries with respect to the alleged breach, they may not be sued under this section for acts taken in a nonfiduciary role." Id. at 325. Finally, it bears noting that the court also affirmed the dismissal of the claims brought against the company. See id. at 326-28.

r. In Tussey v. ABB Inc., No. 06-CV-4305, 2012 WL 1113291 (W.D. Mo. Mar. 31, 2012), participants in ABB, Inc.'s 401(k) plan sued ABB, Fidelity Management and Trust Company, the plan's administrator; and Fidelity Management & Research Company, the investment adviser for approximately half of the investment options available to plan participants. Plaintiffs alleged that defendants breached their fiduciary duties under ERISA by failing to disclose the fact and amount of revenue sharing payments paid to Fidelity. Plaintiffs further alleged that defendants breached their fiduciary duties by failing to capture additional compensation streams for the benefit of the plan, and failing to exercise bargaining leverage to obtain lower fees.

"Having tried this matter over a four-week period, and having reviewed voluminous records and testimony, the Court finds that the ABB Defendants and Fidelity Defendants breached some fiduciary duties that they owed to the . . . Plans. Specifically, the Court finds: (1) ABB Defendants violated their fiduciary duties to the Plan when they failed to monitor recordkeeping costs, failed to negotiate rebates for the Plan from either Fidelity or other investment companies chosen to be on the [Plan] platform, selected more expensive share classes for the . . . Plan's investment platform when less expensive share classes were available, and removed the Vanguard Wellington Fund and replaced it with Fidelity's Freedom Funds; (2) ABB, Inc., and the Employee Benefits Committee violated their fiduciary duties to the Plan when they agreed to pay to Fidelity an amount that exceeded market costs for Plan services in order to subsidize the corporate services provided to ABB by Fidelity; (3) Fidelity Trust breached its fiduciary duties to the Plan when it failed to distribute float income solely for the interest of the Plan; and (4) Fidelity Research violated its fiduciary duties when it transferred float income to the Plan's investment options instead of the Plan." Id. at *2.

The court also noted that "the Plan must be compensated for its losses and any ill-gotten gains by Defendants when they used Plan assets for their own benefit. However, the Court rejects Plaintiffs' global damages theory which is based on the assumption that ABB's breaches infected all of its investment decisions for the Plans and the assumption that damages should thus be measured by the performance of ABB's defined benefit plans." Id. Instead, "the Court has determined the specific damages that resulted from each of the transactions in which ERISA fiduciary duties were breached." Id. (citation omitted). The court found that the ABB defendants were jointly and severally liable for $35.2 million, and the Fidelity defendants were jointly and severally liable "for compensating the Plan $1.7 million for lost float income." Tussey, 2012 WL 1113291, at *40.

Defendants appealed, and on March 19, 2014, the Eighth Circuit affirmed in part and vacated in part the lower court's decision, and remanded one claim to the lower court for further proceedings. Tussey v. ABB, Inc., Nos.12-2056, 12-2060, 12-3974, 12-3875, 2014 WL 1044831 (8th Cir. Mar. 3, 2014).

The court began its analysis by noting that the plan gave the administrator "sole and absolute discretion," and that accordingly, "the Plan administrator's 'interpretation will not be disturbed if reasonable.'" Id. at *4 (quoting Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101, 111 (1989)). The court then agreed with the

ABB defendants that "much of the district court's analysis gives little, if any, deference to the Plan administrator's determinations under Plan documents." Id. In doing so, the court rejected appellee's argument that such deference was applicable only to "benefit claims," noting that the Second, Third, Sixth, Seventh and Ninth Circuits had reached similar conclusions. See id. at *5, n.6.

However, the court affirmed the judgment with respect to plaintiffs' recordkeeping claim and noted that "[t]he district court did not condemn bundling services or revenue sharing, which are common and 'acceptable' investment industry practices that frequently inure to the benefit of ERISA plans." Id. at *6. Rather, it held that the lower court's "factual findings find ample support in the record, and its legal conclusion that the ABB fiduciaries breached their fiduciary duties to the Plan was not in error." Id. at *6. The court also found no abuse of discretion in the district court's $13.4 million award of damages for excessive recordkeeping fees. Id. at *7.

The court next vacated the lower court's finding that the ABB defendants breached their fiduciary duty by replacing the Vanguard Wellington Fund with Fidelity's Freedom Funds because it "shows clear signs of hindsight influence regarding the market for target-date funds at the time of the redesign." Id. at *8. The court also noted that on remand the lower court should reevaluate its damage calculation methodology, "if any," because "[a]s calculated, the $21.8 million damages award . . . is speculative" and exceeds the losses from any potential fiduciary breach. Id. at *9.

The court also vacated the lower court's determination that the Fidelity defendants breached their fiduciary duty by retaining float income. "Under the evidence and circumstances of this case, the Plan investment options held the property rights in the depositary float and were entitled to the float income. Fidelity did not breach any fiduciary duties with respect to the depositary account." Id. at *10.

The court also vacated the award of attorneys' fees in light of the aforementioned rulings. Id. at *10-11.

Finally, a brief dissent disagreed with the majority's reversal on the float claim. The dissent argued that float income should be considered a Plan asset pursuant to Department of Labor regulations implementing ERISA, and that accordingly, the Fidelity defendants breached their fiduciary duty "by transferring float to the Depositary Account for the benefit of investment options and by using float income to pay for bank expenses." Id.

at *11. The dissent also found that Fidelity "failed to negotiate float openly and thus Fidelity was improperly using, for its own benefit, float income which was property of the Plan." Id. at *12.

s. In Santomenno v. Transamerica Life Insurance Co., No. CV 12-02782, 2013 WL 603901 (C.D. Cal. Feb. 19, 2013), plaintiffs brought an action against three Transamerica entities. Transamerica Life Insurance Co. ("TLIC") offered the 401(k) plan product at issue and charged investment management and administrative fees in connection with plaintiffs' investments. Id. at *1-2. Two related entities served as investment managers to certain investment options under the plan, which allowed employees, such as plaintiffs, to invest in mutual funds or collective trusts. Id. at *2.

Plaintiffs alleged, inter alia, that defendants violated their fiduciary duties under ERISA by: (1) charging excessive fees because TLIC provides no services, and "the underlying mutual funds' investment management fees covered [all necessary services]"; (2) improperly receiving revenue sharing payments; and (3) participating in prohibited transactions. See id. at *3.

TLIC moved to dismiss plaintiffs' claims and first argued that it was not a fiduciary, per the rationale of Hecker v. Deere & Co., 556 F.3d 575, 583 (7th Cir. 2009). Santomenno, 2013 WL 603901, at *6. The court rejected this argument as "formalistic line drawing" and noted that "[u]nder ERISA, not only named trustees but those assuming fiduciary functions are deemed to have a fiduciary duty." Id. at *5-6. The court also noted that TLIC is entitled to "reasonable fees and profits for the services that it provides to the plans, but as a fiduciary TLIC is accountable for the reasonableness of those fees." Id. at *6. The court then found that because TLIC was a fiduciary, that TLIC's motion to dismiss plaintiffs' ERISA claims relating to TLIC's fiduciary status (including plaintiffs' revenue sharing claims) must be denied. See id. at *10.

Finally, the court ruled on TLIC's motion to dismiss plaintiffs' prohibited transaction claims, which were based on allegations that TLIC improperly "pa[id] advisory fees from employees' accounts to affiliates . . . for advising or subadvising" services. Id. at *11. The court noted that "mere approval by another fiduciary does not relieve TLIC of potential responsibility for fees being paid to TLIC affiliates." Id.

t. In Krueger v. Ameriprise Financial, Inc., No. 11-cv-02781, 2012 WL 5873825 (D. Min. Nov. 20, 2012), current and former

participants in a 401(k) plan brought a putative class action alleging a variety of ERISA violations.

Plaintiffs alleged that they paid a variety of excessive fees, including fees relating to the administration of the plan, the plan's record-keeping services and that defendants "selected the more expensive share classes" of certain funds. Id. at *5. Plaintiffs also alleged improper investment in, *inter alia*, mutual funds operated by defendant's subsidiaries. Id. at *3-5. Defendants moved to dismiss plaintiffs' claims.

The court denied the motions with respect to all of plaintiffs' ERISA claims, but focused its analysis on plaintiffs' breach of fiduciary duty claim. See id. at *8-15, 22.

The court held that "[p]laintiffs have plausibly argued . . . that Defendants breached their fiduciary duties when they invested in affiliated funds that charged fees that were excessive relative to those available from comparable mutual funds [or other investment options]." Id. at *15. The court noted that plaintiffs alleged the fees charged on the underlying investments "were significantly higher than the median fees paid for comparable mutual funds in 401(k) plans such as funds offered by the Vanguard firm," and that defendants used plaintiffs' retirement assets (and those of other employees) to "seed new and untested affiliated mutual funds, which made those funds more marketable to investors." Id. at *10.

On March 20, 2014, the court granted in part and denied in part defendants' motion for summary judgment on statute of limitation grounds. See Krueger v. Ameriprise Fin., Inc., No. 11-cv-02781, 2014 WL 1117018 (D. Minn. Mar. 20, 2014). Defendants' arguments stemmed from the fact that plaintiffs invested in and reviewed fund documents describing the plan's investment options and service providers more than three years prior to plaintiffs' filing of their action. The court credited this fact and thus dismissed plaintiffs' prohibited transaction claims, as well as a claim that defendants breached their fiduciary duties by having an affiliated entity serve as the plan's record-keeper. Id. at *11, 15.

The court denied defendants' motion, however, with respect to plaintiffs' breach of fiduciary claims relating to defendants' "*selection process*" for choosing the plan's investment options and record-keeper, as there were issues of fact regarding when plaintiffs became aware of how defendants arrived at those decisions. Id. at *9 (emphasis in original); see also Krueger, 2014 WL 1117018, at *17. Because defendants also argued that the complaint's remaining claims should be dismissed if the "selection

process" claims were dismissed, the court likewise sustained plaintiffs' claims regarding defendants' purported failure to monitor the plan's managers, as well as a claim for co-fiduciary liability against Ameriprise for the purported breaches committed by other fiduciaries. Id. Following the decision, the court granted plaintiffs' motion for class certification. Krueger v. Ameriprise Fin., Inc., No. 11-cv-02781, 2014 WL 8106156 (D. Minn. May 23, 2014). While a subsequent motion for partial summary judgment was pending, the parties filed a joint motion for preliminary approval of a class settlement in March 2015.

u. In Danza v. Fidelity Management Trust Company, No. 12-3497, 2013 WL 3872118 (3rd Cir. July 16, 2013), the Third Circuit affirmed a district court opinion, see No. 11–2893, 2012 WL 3599362 (D.N.J. Aug. 20, 2012), granting Fidelity's motion to dismiss ERISA claims against it with respect to a 401(k) plan it administered for the Great Atlantic & Pacific Tea Company, Inc. ("A&P"). The plaintiff alleged that Fidelity, and its affiliate, breached their fiduciary duties by charging excessive service fees in exchange for reviewing Domestic Relations Orders ("DROs"). Danza, 2013 WL 3872118, at *1.

The Third Circuit first affirmed the district court's ruling that Fidelity was not a fiduciary of the plan when it negotiated its trust agreement with A&P, because at that point, Fidelity was engaging in an arms' length transaction. Id. at *2. Next, the court found that although Fidelity was acting as a fiduciary when it charged its fee for reviewing a DRO, Fidelity "did not then control the fee structure, as it was set in the agreement with A & P and Fidelity did not have unilateral discretion to change it. Therefore, Fidelity cannot be held liable as a fiduciary for the challenged conduct, and Plaintiff's Section 404(a) claim fails." Id. at *3 (citing Renfro v. Unisys Corp., 671 F.3d 314 (3d Cir. 2011) (internal citations omitted).

The court then considered plaintiff's claims that Fidelity, as a co-fiduciary, knowingly participated in A&P's breaches of its own fiduciary duty to "defray costs" to the plan. The court rejected this argument because when "A & P and Fidelity negotiated and signed the Trust Agreement, Fidelity was just an arms-length negotiator who owed no duty to plan participants. Hence, Fidelity was not then a fiduciary and therefore could not be considered a co-fiduciary under Section 405." Danza, 2013 WL 3872118 at *3.

Finally, the court found that Fidelity did not engage in any prohibited transactions because: (1) Fidelity was not a "party in interest," as defined by ERISA; and (2) "at the time it collected the

fee, [Fidelity] had no actual control or discretion over the transaction at issue – the price of the previously bargained-for fees." Id. at *4-5 (footnote omitted).

D. Selected Regulatory Developments

Investment advisers, mutual funds, as well as mutual fund directors, are, of course, subject to comprehensive regulatory regimes and, by extension, investigations and enforcement actions. In addition to the above-mentioned developments in civil litigation, the mutual fund industry should be aware of the following regulatory developments.

a. In In the Matter of J. Kenneth Alderman, CPA, et al., No. 3-15127, Release No. 30557 (June 13, 2013), the SEC settled an enforcement proceeding with eight mutual fund directors of Morgan Keegan branded mutual funds. The Commission found that the directors failed in their obligations to determine the appropriate methodology for fair valuation of securities in the funds and to continuously review both the methodology in place and the valuation findings concerning those securities. Id. at 10-11.

Specifically, the Commission found that the directors delegated to the adviser's Valuation Committee the responsibility of making fair value determinations and only provided a general list of factors for the Committee to consider that did not amount to a "meaningful methodology or other specific direction on *how* to make fair value determinations for specific portfolio assets or classes of assets." Id. at 5 (emphasis in original). The Commission also found that the directors did not request or receive sufficient information to evaluate the methodology that was being used by the Valuation Committee, as well as Fund Accounting personnel. Id. at 6-9. This was problematic as Fund Accounting implemented deficient fair valuation procedures, including routinely accepting fair value prices provided by the funds' portfolio manager without any explanation of the basis for those prices. Id. at 6. As a result, the Commission found that the directors violated Rule 38a-1 of the Investment Company Act, which requires funds to adopt policies reasonably designed to prevent violations of the securities laws, including by providing fair value methodologies. Id. at 11-12.

b. On August 14, 2013, the SEC Division of Investment Management published an update addressing "Disclosure and Compliance Matters for Investment Company Registrants that Invest in Commodity Interests" (the "Update"). IM Guidance Update No. 2013-05. The Update was intended to assist funds investing in derivatives with "preparing disclosure filings and in their consideration of compliance issues." Id. at 1. In particular, the

Update noted that the SEC worked with the CFTC, which revised its registration requirements in February 2012 for determining which fund sponsors should be required to register as commodity pool operators ("CPO"), "to harmoniz[e] the requirements of the SEC and CFTC in a manner that would result in the provision of material information to investors in funds that invest in commodity interests without imposing duplicative, inconsistent, and burdensome requirements on funds and their sponsors." Id. [28]

The Update stated that the staff "believes that all funds that use or intend to use derivative instruments should assess the accuracy and completeness of their disclosure, including whether the disclosure is presented in an understandable manner using plain English." The staff also noted that "principal investment strategies" disclosure related to derivatives should be "tailored specifically to how a fund expects to be managed and should address those strategies" that could have a "significant effect" on its performance. Id. at 2.

The staff went on to say that a fund's "principal risks" disclosures should be "tailored to the types of derivatives used by the fund, the extent of their use," and their purpose. Id. The Update emphasized that such prospectus disclosure "should provide an investor with a complete risk profile of the fund's investments taken as a whole," and noted that "investment strategies that employ derivatives, including commodity interests" may introduce additional risks. Id. at 2-3. As such, the staff expects funds employing such strategies to disclose "material risks relating to volatility, leverage, liquidity, and counterparty creditworthiness." Id. at 3.

Regarding "performance presentations," with respect to new funds with nonexistent or short performance histories, the Update noted "that a fund may include in its prospectus information concerning the performance of private accounts and other funds managed by the fund's adviser that have substantially similar investment objectives, policies, and strategies to the fund," so long as such

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[28] On August 13, 2013, the CFTC issued its final "harmonization" rules applicable to funds whose advisers must now also register as CPOs. 78 Fed. Reg. 52308 (to be codified at 17 C.F.R. pt. 4). Under these rules, the CFTC will generally accept compliance with the SEC's requirements as "substituted compliance" for substantially all of the CFTC's relevant Part 4 regulations, as long as the CPO of the fund complies with the statutory and regulatory compliance regime to which it or the fund is subject; otherwise, the CPO may be subject to enforcement actions. Id. at 52310-11. However, CPOs that intend to rely on compliance with SEC requirements must file a notice, as well as their financial statements, with the National Futures Association. Id. at 52311, 52328.

information is not misleading and does not "obscure or impede the understanding" of required prospectus information. Id. Funds should not exclude the performance of other similar funds if such exclusion "would cause the performance shown to be materially higher or more favorable." Id. at 4.

Further, the Update noted that just as Rule 481 under the 1933 Act requires funds to state on their prospectuses that the SEC has not passed on the accuracy of their disclosures, "the staff would not object" to the inclusion of similar information pertaining to the CFTC, if a fund invests in commodity interests. Id.

The Update also noted the staff's expectation "that funds and their advisers would adopt policies and procedures that address . . . the consistency of fund portfolio management with disclosed investment objectives and policies, strategies, and risks," and that funds have policies "sufficient to address the accuracy of disclosures made about the fund's use of derivatives." Id. at 5. Funds are also "remind[ed]" that they must disclose in statements of additional information the extent of the board's role in the risk oversight process. Id.

The Guidance Update concluded by noting the recent creation of a "Risk and Examinations Office" within the Division of Investment Management, which is responsible for "analyzing and monitoring the risk management activities of investment advisers, investment companies, and the investment management industry as well as new products." Id. at 6. This group has begun conducting on-site visits to investment advisers, which are designed to increase the staff's understanding of risk management activities, generate dialogue between the staff and firms on key issues facing the industry and help "inform policy and the examination process." Id.

c. In In the Matter of Chariot Advisors, LLC, No. 3-15433, 2013 WL 4455433 (Aug. 21, 2013), the SEC issued an order (the "Order") instituting cease-and-desist administrative proceedings against Chariot Advisors, LLC ("Chariot") and its control person, which advised a fund in the Northern Lights Variable Trust. The Order alleged that Chariot, through its control person, misrepresented its "ability to conduct algorithmic currency trading—and, as a result, misled the Fund's board about the nature, extent, and quality of services that [Chariot] could provide." Id. at 2. The SEC alleged that when the "Chariot Fund" launched in July 2009, Chariot "had not devised or otherwise possessed any algorithms or other computer models capable of engaging in the currency trading . . . described during the 15(c) process." Id. Rather, after the fund

launched, Chariot hired an individual trader, contrary to what was represented to the fund's board. Id.

Due to the conduct described above, the SEC alleged that Chariot willfully violated Section 15(c) of the Investment Company Act, which was aided and abetted by its control person. Id. at 8. Chariot and its control person were also charged with aiding and abetting (and causing) the Chariot Fund to violate the disclosure requirements of Section 34(b) of the Investment Company Act, which prohibits material misstatements and omissions in documents filed pursuant to the Act. Id. Chariot was also charged with violations of Sections 206(1), 206(2) and 206(4) of the Investment Advisers Act, which prohibit fraudulent conduct by an investment adviser, and Rule 206(4)-8 promulgated thereunder, which prohibits the making of material misstatements or omissions. Id. Chariot's control person was also charged with aiding and abetting Chariot's violations of Sections 206(1) and 206(2) of the Investment Advisers Act. Id. The SEC sought a variety of relief, including disgorgement of profits and civil penalties. Id.

In July 2014, the parties entered a consent order under which Chariot was ordered to cease and desist from the alleged violations, and Chariot's control person was suspended for one year and ordered to pay a civil money penalty. In the Matter of Chariot Advisors, LLC, No. 3-15433, 2014 WL 2986899 (July 3, 2014).

d. On August 27, 2013, the SEC's National Exam Program released a risk alert (the "Alert") that summarized the staff's observations after a review of many advisers' business continuity plans following Hurricane Sandy, as well as several recommendations that aim to make such plans better. In particular, the Alert recommended advisers to: (1) develop policies and procedures capable of responding not only to short-term disruptions, but to "widespread" and "extended" events; (2) evaluate the preparedness of third-party service providers; and (3) contact customers "before a major storm to see if they have any transactions . . . they will need executed if an extended outage occurs."

e. In In the Matter of Western Asset Management Co., File Nos. 3-15688, 3-15689, Investment Company Act Release No. 30893, Investment Advisers Act Release Nos. 3762 and 3763 (Jan. 27, 2014), the SEC settled cease-and-desist proceedings against Western Asset Management, a subsidiary of Legg Mason, Inc. The Commission found that Western Asset engaged in cross trading that favored certain clients and concealed investor losses

resulting from a coding error. Although Western Asset did not admit or deny any of the Commissions' findings, Western Asset agreed to be censured and paid $21 million to settle the proceedings.

With respect to cross trading, the Commission found that Western Asset aided and abetted and caused violations of Sections 17(a)(1) and 17(a)(2) of the Act, and violated Sections 206(2) and 206(4) of the Investment Advisers Act of 1940, when it arranged for certain mortgage-backed securities to be sold from one set of Western Asset's clients to another. Specifically, the Commission found that because Western Asset had the securities sold at the bid price instead of the average of the bid and ask price, Western Asset allowed the "buying" clients to enjoy the full benefit of the market savings on the trades at the expense of the "selling" clients. See Release for File No. 3-15688 at 2.

With respect to the coding error (which affected different clients), the Commission found that Western Asset violated Sections 206(2) and 206(4) of the Advisers Act by failing to disclose and correct an error that caused approximately 100 ERISA clients to improperly invest in a private placement, which ultimately fell in value. The Commission found that Western Asset waited approximately two years to notify the clients of the issue, and also failed to reimburse those clients with respect to their losses. See Release for File No. 3-15689 at 4-6.

VI. CONCLUSION

The Act continues to be a source of securities claims, but the viability of those claims remains unclear. Although many courts continue to restrict the scope of cases brought under Section 36(b) of the Act, plaintiffs continue to attack conduct with claims under that Section. In light of the Supreme Court's March 30, 2010 decision in Jones v. Harris Associates L.P., which both the industry and the plaintiffs' bar claim as a victory, it is unclear whether plaintiffs will continue to view Section 36(b) as an attractive cause of action in view of the burden of proof imposed upon those seeking to recover. Although the recent filing of "manager of managers" cases suggests that plaintiffs have not yet given up on Section 36(b), Jones should deter plaintiffs from using Section 36(b) as a vehicle to attack conduct beyond excessive fees.

Meanwhile, litigation involving mutual funds and their investment advisers under the 1933 Act, 1934 Act, and ERISA continues with vigor. Plaintiffs have been meeting with mixed success under these statutes, but the filing of new suits against fund advisers continues.

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