ISN’T THIS WHERE WE CAME IN?: AN EXAMINATION OF THE TURBULENT HISTORY AND DIVERGENT ECONOMICS UNDERLYING SECTION 36(B) OF THE INVESTMENT COMPANY ACT OF 1940 AND A PROPOSAL TO FINALLY PUT THE LAW TO USE

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I. INTRODUCTION

It is easier to invest in the stock market now than it has ever been. With the proliferation of the Internet, online investing websites have nearly obliterated the need for stockbrokers and have given individuals the ability to invest in whatever they choose—for around seven dollars per trade, a person can own a share of almost any publicly traded company.\(^1\) While this is certainly a step forward for the world of investing, it does not come

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can lead to an undiversified portfolio and a lot of uncompensated risk.
Investors learned this the hard way when the market began to fall in 2007. 2
As a result, many young investors have become shell-shocked and wary of
inventing in the stock market. 3 According to the Investment Company
Institute, in 2005, 48 percent of people under age thirty-five said they were
“willing to take substantial or above-average risks in their portfolios”—that
number at the start of 2011 had fallen to 34 percent. 4

It is not necessary, however, to rely solely on one’s own investing
prowess when trying to navigate the stock market. Trained professionals
offer their services in many forms—almost always for a price. Mutual
funds represent one of the most significant ways in which trained
professionals are involved with the investment decisions of others. “A
mutual fund is a pool of assets, consisting primarily of [a] portfolio [of]
securities, and belonging to the individual investors holding shares in the
fund.” 5 In 2009, 43 percent of all households in the United States owned
mutual funds, with an estimated total of 51,200,000 households invested in
mutual funds. 6 The total amount of assets in mutual funds in 2009 was over
eleven trillion dollars. 7 Clearly, many people rely on the abilities of mutual
fund managers to guide their investment decisions. By purchasing shares in
mutual funds, people can own shares of portfolios that are as diversified as
they desire without having to pick investments on their own.

One would expect to be able to choose a mutual fund that has a
competent manager, perhaps based on that manager’s past performance,
and to be able to at least beat funds with lower management fees, like
passively managed funds in which the managers reduce fees, generally by
tracking an index rather than attempting to pick the best stocks. This,
however, is not the case. Mutual fund managers tend to underperform
passive benchmarks and the performance of individual mutual fund
managers is generally not predictable based on past performance. 8 It would

2. See, e.g., Hibah Yousuf & Penelope Wang, The Young and the Riskless Shun the Market,
young_investors.moneymag/ (detailing the account of a thirty-year-old nurse who began investing
online at age twenty-four by putting 100 percent of her investment in a taxable account and a Roth IRA,
only to lose over half of her Roth in a one-year span).
3. Id.
4. Id.
7. Id.
also seem reasonable to expect that offering higher fees to managers, perhaps additional fees contingent upon the manager besting the return of some benchmark, would cause managers to achieve better returns. This, however, is also not the case. Offering an incentive fee to managers for outperforming some benchmark does not, on average, cause managers to beat the benchmark by achieving higher returns.\footnote{9}

With investors cautious of venturing into the stock market on their own, and with mutual fund managers seemingly charging fees for a job poorly done, many investors seem to be stuck between a rock and a hard place. Obviously, mutual fund managers are not completely useless—there is evidence of this from the sheer number of investors who choose to place their money into these funds. Even if managers do serve some benefit to investors, it is imperative that these investors receive some protection from fund managers who charge unreasonably large fees for their services. This is especially true now, with individuals cautious of investing on their own and an ever-increasing amount of money flowing into mutual funds.\footnote{10}

The government recognized this need for protection over forty years ago and in 1970 amended the Investment Company Act of 1940 by adding section 36(b).\footnote{11} This amendment created a private right of action for investors against an investment adviser who breaches a “fiduciary duty” with respect to compensation or payments for services.\footnote{12} The legislature, however, failed to provide a meaning of “fiduciary duty” and since the statute was enacted the courts have shouldered this burden. In 1982, the Second Circuit set forth what was to become the prevailing meaning of “fiduciary duty” under section 36(b) in \textit{Gartenberg v. Merrill Lynch Asset Management, Inc}.\footnote{13} \textit{Gartenberg} established the test of whether a fiduciary duty has been breached by an investment adviser to be “whether the fee schedule represents a charge within the range of what would have been negotiated at arm’s-length in the light of all of the surrounding

\footnotesize{
\footnote{9} Edwin J. Elton, Martin J. Gruber & Christopher R. Blake, \textit{Incentive Fees and Mutual Funds}, 58 J. FIN. 779, 802 (2003). While this study suggests that managers who are offered incentive fees have not outperformed their benchmarks, it does suggest that funds with incentive fees may have at least some tendency to attract superior managers because these funds average a slightly higher risk-adjusted performance. \textit{Id}. Nonetheless, the study suggests that offering incentive fees does not lead to returns that are superior to the chosen benchmarks. \textit{Id}.
\footnote{10} U.S. CENSUS BUREAU, \textit{supra} note 6. In 1990 around one trillion dollars were invested in mutual funds, and by 2009 this amount had risen to over eleven trillion dollars. \textit{Id}.
\footnote{12} \textit{Id}.
\footnote{13} Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 694 F.2d 923 (2d Cir. 1982).
}
circumstances.” The case went on to clarify that a section 36(b) violation requires “a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm’s-length bargaining.” The approach taken in Gartenberg was widely accepted until 2008, when the Seventh Circuit explicitly condemned the Gartenberg method in Jones v. Harris Associates, L.P. Under the Seventh Circuit’s approach, an investment adviser can charge a limitlessly high fee without violating the adviser’s fiduciary duty to investors so long as the adviser provides the investor with full disclosure and deals with the investor truthfully. The United States Supreme Court reversed the Seventh Circuit’s decision in Jones, however, and reinstated the Gartenberg standard in 2010.

Although the highest Court has determined that the Gartenberg method best fits the meaning of “fiduciary duty” within section 36(b) of the Investment Company Act of 1940, this paper will argue that while both the Gartenberg approach and the Seventh Circuit’s approach in Jones have their advantages, neither gives “fiduciary duty” under section 36(b) a meaning that is both workable and useful—adopting either scheme will either fail to provide adequate protection to investors or force courts to exceed their capabilities in determining the outcome of the case. Part II describes the basic structure of a mutual fund. Part III examines the legislative history behind section 36(b) of the Investment Company Act of 1940. In Part IV, this Note analyzes the various approaches that courts have taken in section 36(b) litigation and the problems with these approaches. Part V examines the competing economic viewpoints concerning market forces in the mutual fund industry as a means of restraining advisers’ fees. Part VI reviews other ideas that have been proposed to address the problem with section 36(b). Part VII analyzes the current problem with section 36(b) and proposes that as a solution to this problem, a special committee of financial experts should be authorized to handle section 36(b) claims in a manner similar to the way that the Equal Employment Opportunity Commission handles claims made under Title VII of the Civil Rights Act of 1964.

14. Id. at 928.
15. Id.
17. Id. at 632.
II. MUTUAL FUND STRUCTURE

Mutual funds are open-ended investment funds operated by investment companies registered under the Investment Company Act of 1940. A mutual fund is “open-ended” because the fund manager continues to invest new cash from investors, and the fund continues to sell new shares to new investors. A mutual fund is started by the fund’s sponsor who organizes the fund as a business or trust under state law, registers the fund with the Securities and Exchange Commission (“SEC”) under the Investment Company Act of 1940, registers the fund’s shares for sale to the public under the Securities Act of 1933, obtains at least $100,000 in capital, makes any filings and pays any fees necessary in the states in which the fund will sell its shares, and completes any other tasks which may arise in the process of starting the fund.

A mutual fund is managed by an investment adviser who chooses what investments the fund will make and purchases whatever securities, bonds, or other investments the fund adviser believes will constitute the ideal structure of the fund—this differs from fund to fund depending on the fund’s objectives and is communicated to shareholders and prospective shareholders through the fund’s prospectus. The price of a share in a mutual fund is governed by the prices of the underlying investments owned by the fund and is not driven by an open market supply and demand for the shares. Every mutual fund has a board of directors, no more than sixty percent of whom may be interested persons with respect to the fund, who oversee the decisions of the fund’s adviser and, depending on the structure of the fund, may have the ability to approve or disapprove of the fee amount charged for the adviser’s services. While there are no specific

19. Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 to -64 (2006). See also § 80a-3 (for the definition of an investment company under the Act); § 80a-8 (for the rules regarding the registration of investment companies).
20. See § 80a-5(a)(1).
21. See § 80a-1 to -64.
22. See § 80a-2(a)(20).
23. § 80a-10(a). “Interested person,” as defined in the Investment Company Act, includes “any affiliated person of such company,” the immediate family members of the “affiliated person,” an interested person of the investment adviser or principal underwriter of the company, past legal counsel of the company, any person who has executed transactions for the company or another company with the same adviser, any person who has loaned money or property to the company or to another company with the same adviser, and any person who, within the past two years, has had a material business or professional relationship with the company. § 80a-2(a)(19). See the full text of the Act for greater detail. The Act defines “affiliated person” with respect to an investment company as “any investment adviser thereof or any member of an advisory board thereof.” § 80a-2(a)(3)(E).
24. See § 80a-10(a) (stating rules governing the makeup of the board of directors); § 80a-16
legal requirements for the qualifications of members of a mutual fund’s board of directors, it is important that each director is capable of completing the tasks required of the board including, most importantly, “oversee[ing] the management and operations of the fund on behalf of the fund’s shareholders.”

III. HISTORY OF SECTION 36(B) OF THE INVESTMENT COMPANY ACT OF 1940

On August 22, 1940, Congress passed the Investment Company Act of 1940. Using its authority under the Commerce Clause of the United States Constitution, Congress passed this law with the purpose of effectively regulating investment companies, which had previously only been subject to state regulation. Congress had “concern with the potential for abuse inherent in the structure of investment companies” and recognized the harm that could befall investors without proper oversight of the investment company industry, particularly “when investment companies are . . . managed . . . in the interest of . . . investment advisers . . . rather than in the interest of . . . such investment companies’ security holders.” Congress declared the purpose of this new law to be “to mitigate and, so far as is feasible, to eliminate the conditions . . . which adversely affect the national public interest and the interest of investors.”

It was with this policy statement in mind that thirty years later, in 1970, Congress amended the Investment Company Act of 1940 with section 36(b) to include a provision explicitly demanding the fiduciary duty of investment advisers with respect to management fees charged to investors.

The amendment was first put into motion when, in 1958, the SEC commissioned the Wharton Report from the University of Pennsylvania’s business school in order to study problems created by the size of investment companies; these included both the effects of a company’s size
on the investment policies of the company and the effects of a company’s size on the security markets.\(^{31}\) Importantly, the agreement also included the request to collect and analyze data and statistics related to the character of management and the performance of investment companies.\(^{32}\) When the report was completed in 1962, the study had shifted from its original purpose and focused primarily on the presence of arm’s-length negotiation between fund advisers and fund boards over adviser compensation.\(^{33}\) The study revealed that fees paid to investment advisers for their work did not correlate with the cost of performance of their services or with investment results.\(^{34}\) In other words, the study doubted that arm’s-length negotiation was present in the fund industry.\(^{35}\)

The SEC conducted its own report and released it in 1966.\(^{36}\) The findings of the SEC’s report were consistent with the findings of the Wharton Report.\(^{37}\) The SEC’s report found that competition in the fund industry was not sufficient to create arm’s-length negotiations and attributed this to a lack of competition between advisers to manage specific funds and a price inelasticity that prevented fee prices from being reduced due to the similarity in funds’ prices and the high transaction costs that discouraged investors from switching funds.\(^{38}\)

The findings of the Wharton Report and the SEC’s report led the SEC to the conclusion that the regulations on advisory fees that were in place at that time did not adequately protect investors from overreaching by advisers.\(^{39}\) As a result, the SEC proposed its recommendations to both houses of Congress in May of 1967.\(^{40}\) The SEC’s proposal recommended that fund advisers charge no more than a “reasonable” fee, with reasonableness determined by the nature of the services provided, the


\(^{32}\) Id.

\(^{33}\) WHARTON SCH. OF FIN. & COMMERCE, A STUDY OF MUTUAL FUNDS, H.R. REP. NO. 87-2274, at 1–4 (1962) [hereinafter WHARTON REPORT].

\(^{34}\) Id. See also Amy Y. Yeung & Kristen J. Freeman, Gartenberg, Jones, and the Meaning of Fiduciary: A Legislative Investigation of Section 36(b), 35 Del. J. Corp. L. 483, 494 (2010).

\(^{35}\) WHARTON REPORT, supra note 33, at 3; Yeung & Freeman, supra note 34, at 495.

\(^{36}\) SEC, PUBLIC POLICY IMPLICATIONS OF INVESTMENT COMPANY GROWTH, H.R. REP. NO. 89-2337 (1966) [hereinafter SEC REPORT].

\(^{37}\) Id. See also Yeung & Freeman, supra note 34, at 496.

\(^{38}\) Yeung & Freeman, supra note 34, at 496–97. See also SEC REPORT, supra note 36, at 126.

\(^{39}\) Yeung & Freeman, supra note 34, at 498.

quality of the services, the value of the benefits received by the adviser, and any other relevant factors. Under the SEC’s proposal, the plaintiff would have to prove unreasonableness by a preponderance of the evidence.

Negotiations over the proposed legislation ensued between the SEC and the Investment Company Institute (“ICI”), an association of fund advisers. The ICI disagreed with the findings of the Wharton Report and the SEC’s report and made its own recommendations for the new legislation. The ICI asserted that there was plenty of competition in the fund industry because investors could choose between many funds, and that the appropriate place for investors to challenge the decisions of fund advisers was in court, as would be the case in any other corporation. The ICI then recommended additional director independence on a fund’s board and proposed giving the protection of the business judgment rule to decisions made by independent directors. The SEC and the ICI presented expert witnesses to Congress to try to determine whether a court has the ability to apply a reasonableness standard, with the SEC contending that courts do have this ability and the ICI doubting this contention.

Originally, Senate Bill 3724 was put before both the Senate and the House, as Senate Bill 34, in order to amend section 15 of the Investment Company Act. After much debate over the terms of the amendment, a compromise was reached, and it was agreed that the amendment would add a new section, 36(b), to the Investment Company Act, rather than changing section 15. The new language in the Senate Bill for section 36(b) opted to include a “fiduciary duty” with respect to the compensation of investment advisers, and in determining if a breach had occurred the new language advocated giving as much weight as the court should “deem appropriate under all the circumstances” to board ratification and shareholder approval of the compensation. The Senate Bill went before a House Subcommittee, along with another bill proposed by Representative Stuckey of Georgia that differed slightly from the Senate Bill. The SEC stood by the Senate Bill

41. Yeung & Freeman, supra note 34, at 499–500.
42. S. 1659 § 8(d)(3); H.R. 9510 § 8(d)(3).
43. Yeung & Freeman, supra note 34, at 500–01.
44. Id. at 501.
45. Id. at 502.
46. Id. at 502–03.
47. Id. at 503.
51. Id.
as the proper language to represent the compromise between itself and the ICI.\(^{53}\) The Committee looked at both Bills and closely examined the change in language throughout the history of the proposed legislation from a “reasonableness” standard to a “fiduciary duty” standard.\(^{54}\)

The Committee asked for the SEC and the ICI to expound on the meaning of “fiduciary duty” in the context of their proposed legislation.\(^{55}\) In the SEC’s view, the change to fiduciary duty represented a procedural change, rather than a substantive change.\(^{56}\) The SEC compared the fiduciary duty set forth in the Bill with the fiduciary duties involved in an interested corporate transaction that courts would examine under “entire fairness.”\(^{57}\) The SEC stated that a breach of the fiduciary duty “would occur when compensation to the adviser for his services is excessive in view of the services rendered—where the fund pays what is an unfair fee under the circumstances.”\(^{58}\) The ICI interpreted the change as both procedural and substantive.\(^{59}\) The ICI viewed the reasonableness standard as requiring courts “to substitute their business judgment for that of the directors of the fund.”\(^{60}\) They viewed the fiduciary duty standard, on the other hand, as requiring courts to look to the principles of fiduciary law.\(^{61}\) In the ICI’s view, a fiduciary “may not overreach in the amount of his fee even though the other party to the transaction, in full possession of all the facts, does not believe the fee is excessive.”\(^{62}\)

The final bill, House Bill 17333, used the fiduciary duty language proposed by the SEC and the ICI and was signed into law on December 14, 1970.\(^{63}\) This bill did not, however, clarify what Congress intended


\(^{54}\) See 1969 House Hearings, supra note 53, at 184–95; Yeung & Freeman, supra note 34, at 508.

\(^{55}\) 1969 House Hearings, supra note 53, at 184–95; Yeung & Freeman, supra note 34, at 508.

\(^{56}\) In the SEC’s view, the change was procedural because its intent was to “shift the focus of any litigation . . . from the directors . . . to the investment adviser.” 1969 House Hearings, supra note 53, at 190; Yeung & Freeman, supra note 34, at 508.

\(^{57}\) 1969 House Hearings, supra note 53, at 190; Yeung & Freeman, supra note 34, at 508.

\(^{58}\) 1969 House Hearings, supra note 53, at 190; Yeung & Freeman, supra note 34, at 508.

\(^{59}\) 1969 House Hearings, supra note 53, at 190; Yeung & Freeman, supra note 34, at 508–9.

\(^{60}\) 1969 House Hearings, supra note 53, at 441; Yeung & Freeman, supra note 34, at 509.

\(^{61}\) 1969 House Hearings, supra note 53, at 441; Yeung & Freeman, supra note 34, at 509.

\(^{62}\) 1969 House Hearings, supra note 53, at 441; Yeung & Freeman, supra note 34, at 509.

\(^{63}\) 1969 House Hearings, supra note 53, at 441; Yeung & Freeman, supra note 34, at 509.

\(^{64}\) 116 Cong. Rec. 41,623 (1970); Yeung & Freeman, supra note 34, at 510.
“fiduciary duty” to mean.

IV. COURT INTERPRETATIONS OF “FIDUCIARY DUTY” UNDER SECTION 36(B)

A. THE GARTENBERG APPROACH

Section 36(b) of the Investment Company Act of 1940 imposes on an investment adviser a “fiduciary duty with respect to the receipt of compensation for services” but fails to elaborate on the meaning of “fiduciary duty” within the statute.65 Due to this lack of clarity, courts were left with the job of interpreting the statute after it became law in 1970. In 1982, the Second Circuit decided Gartenberg v. Merrill Lynch Asset Management, Inc.,66 and the standard set forth in this case became “something of a consensus” in federal courts.67 The court in Gartenberg determined that the appropriate test of whether the fiduciary duty of an investment adviser has been breached is “whether the fee schedule represents a charge within the range of what would have been negotiated at arm’s-length in the light of all of the surrounding circumstances,” and that a violation requires “a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm’s-length bargaining.”68

The court in Gartenberg addressed a claim made by shareholders in a money market fund who contended that the fees paid by the fund to the manager were so disproportionately large that they constituted a breach of the fiduciary duty requirement under section 36(b) of the Investment Company Act of 1940.69 The Gartenberg court examined the legislative history of section 36(b)70 and observed that Congress failed to define “fiduciary” or to distinguish the “fiduciary” standard set forth in the final bill from the “reasonableness” standard that was used in prior bills.71 The court also pointed out that Congress made “no attempt to set forth a definitive test by which observance or breach of fiduciary duty was to be determined.”72 The Gartenberg court quoted Senate Report 91-184 for the

68. Gartenberg, 694 F.2d at 928.
69. Id. at 925.
70. Id. at 927–28. See supra Part III.
71. Gartenberg, 694 F.2d at 928.
72. Id.
contention that

Since a typical fund is organized by its investment adviser which provides it with almost all management services and because its shares are bought by investors who rely on that service, a mutual fund cannot, as a practical matter sever its relationship with the adviser. Therefore, the forces of arm’s-length bargaining do not work in the mutual fund industry in the same manner as they do in other sectors of the American economy.\textsuperscript{73}

The court took this opportunity to set forth its own test based on “arm’s-length” negotiation, rejecting the lower court’s method of evaluating a fee’s fairness based on the price charged by similar advisers, on the theory that while competition may exist between different funds to attract shareholder business, this does not necessarily mean that manager-advisers must compete for fund business—meaning that reliance on prevailing industry fees will not, alone, satisfy section 36(b).\textsuperscript{74} Pointing to the weak motivation for fund shareholders to choose a fund based on the manager’s fee,\textsuperscript{75} the \textit{Gartenberg} court advocated an all-inclusive approach to assessing an excessive fee in which weight should be given to “the adviser-manager’s cost in providing the service, the nature and quality of the service, the extent to which the adviser-manager realizes economies of scale as the fund grows larger, and the volume of orders which must be processed by the manager,” in addition to other factors, including approval by an independent board and prices of comparable funds.\textsuperscript{76} The \textit{Gartenberg} court held that the size of a fee could be “so disproportionately large as to amount to a breach of fiduciary duty in violation of § 36(b)” without the plaintiff having to show any intent to defraud.\textsuperscript{77}

Ultimately, the court in \textit{Gartenberg} ruled that the fund adviser had not breached the fiduciary duty under section 36(b) because the plaintiffs failed to show that the services were not of the highest quality, the investors enjoyed a better-than-average return, and any increases in the fund’s management fees could be explained by a tremendous increase in the size of the fund, thus making the manager’s duties more difficult and costly.\textsuperscript{78}

\textsuperscript{73} Id. at 928 (quoting S. REP. NO. 91–184, at 4901 (1970)).

\textsuperscript{74} Id. at 928–29.

\textsuperscript{75} Id. at 929 (“In the present case, for instance, the alleged excessive Manager’s fee amounts to $2.88 a year for each $1,000 invested.”).

\textsuperscript{76} Id. at 929–30.

\textsuperscript{77} Id. at 930 (turning to the language of § 36(b)(1), the court pointed out that the statute relieves plaintiffs of the necessity of proving the personal misconduct of any defendant).

\textsuperscript{78} Id.
B. THE SEVENTH CIRCUIT’S APPROACH IN JONES

In 2008, a Seventh Circuit panel addressed a similar issue to that in Gartenberg in Jones v. Harris Associates. L.P., in which shareholders in a mutual fund contended that the fund’s fees were too high, in violation of section 36(b). In this case, however, Judge Easterbrook decided to diverge from the Gartenberg norm and addressed the issue in a different way.

The plaintiffs in Jones urged the Seventh Circuit to diverge from the Gartenberg method, arguing that the Second Circuit relied too much on market prices in evaluating the reasonableness of fees and the appropriate market for a benchmark fee should be the market for advisory services provided to unaffiliated institutional clients, as opposed to fees charged to individual clients. Observing that the Second Circuit had also been skeptical of using market prices to evaluate the reasonableness of fees, Judge Easterbrook pointed out that the Second Circuit had failed to explain adequately the grounds for such skepticism. The Second Circuit attributed its skepticism to low competition between fund advisers that resulted in a failure to restrain investment advisers’ fees, but Judge Easterbrook noted that the only basis given by the Second Circuit for such a contention was the observation that mutual funds generally do not advertise the level of management fees and, instead, usually only make public a fund’s total expenses as a percentage of assets. While the plaintiffs in Jones claimed that Gartenberg relied too much on market prices in its analysis, Judge Easterbrook believed that Gartenberg relied too little on market prices in its analysis. According to Easterbrook, fund managers have an incentive to hold down management fees because lower fees lead to a higher return on investment for fund shareholders. Because shareholders are free to switch funds, Easterbrook postulated, high administrative expenses would induce shareholders to switch funds, and an adviser cannot make money from a fund without investors. Thus, according to Judge Easterbrook,

80. Id. at 632 (expressing skepticism regarding the Gartenberg approach).
81. Id. at 631. An unaffiliated institutional investor, as opposed to an individual investor, is an investor that manages a large amount of money that it invests for some aggregate of individuals—an example of such an investor is a pension fund. Id.
82. Id.
83. Id.
84. Id. at 632.
85. Id. at 631–32.
86. Id. at 632.
competition between funds to retain investors should hold down management fees.\textsuperscript{87}

Judge Easterbrook and the Seventh Circuit then explicitly rejected the \textit{Gartenberg} method and set forth their own approach.\textsuperscript{88} According to the Seventh Circuit, “[a] fiduciary must make full disclosure and play no tricks but is not subject to a cap on compensation.”\textsuperscript{89} Observing that section 36(b) does not use the “reasonableness” language set forth in prior bills, and instead applies a fiduciary duty, Judge Easterbrook and the Seventh Circuit turned to the law of trusts to determine how to interpret this duty.\textsuperscript{90} The court looked to the \textit{Restatement of Trusts} and determined that “[a] trustee owes an obligation of candor in negotiation, and honesty in performance, but may negotiate in his own interest and accept what the settlor or governance institution agrees to pay.”\textsuperscript{91} Thus, when the settlor or person in charge of administering the trust agrees to the level of compensation, the court does not need to make any sort of inquiry into what is “reasonable.”\textsuperscript{92} Comparing the approach adopted here to that used by publicly traded corporations to determine the compensation paid to top-level managers, the court noted that courts do not inquire into the “reasonableness” of salaries paid because while competition as a force to restrain these fees may be imperfect, it remains superior to a “just price” system set by the judiciary because judges cannot be ousted from office for having poor business judgment.\textsuperscript{93}

Finally, Judge Easterbrook briefly examined the legislative history of section 36(b) and rejected any connection between the “fiduciary duty” language used in the final statute and the “reasonableness” language used in prior forms of the bill.\textsuperscript{94} Easterbrook rejected the connection because the final statute failed to embody such language and because any statements made during House and Senate debates advocating a reasonableness standard were based on conceptions of mutual fund competition that he believed to be outdated and no longer relevant.\textsuperscript{95} To support the contention that the information possessed by Congress when section 36(b) was debated was outdated, Easterbrook pointed to the vast number of mutual

\begin{itemize}
\item \textsuperscript{87} \textit{Id.} at 631–32.
\item \textsuperscript{88} \textit{Id.} at 632.
\item \textsuperscript{89} \textit{Id.}
\item \textsuperscript{90} \textit{Id.}
\item \textsuperscript{91} \textit{Id.} (citing \textit{RESTATMENT (SECOND) OF TRUSTS} § 242 & cmt. f (1959)).
\item \textsuperscript{92} \textit{Id.}
\item \textsuperscript{93} \textit{Id.} at 632–33.
\item \textsuperscript{94} \textit{Id.} at 633.
\item \textsuperscript{95} \textit{Id.} at 633–34.
\end{itemize}
funds available in 2008 compared to the relatively scant number available when Congress passed section 36(b) and the ability of investors to cheaply move money to other funds, although he did concede that “[m]utual funds rarely fire their investment advisers.”

In the end, the Seventh Circuit affirmed the district court’s ruling and rejected the plaintiffs’ claim that the fees charged were excessive and violated section 36(b).

The plaintiffs petitioned for rehearing en banc, but the Seventh Circuit panel denied this petition, with Judge Posner dissenting. Posner’s dissent recognized that Judge Easterbrook’s opinion in Jones was the only appellate decision on record disagreeing with Gartenberg, while there were many decisions affirming Gartenberg. Judge Posner went on to criticize Easterbrook’s opinion for relying too heavily on economic analysis that “is ripe for reexamination.”

C. THE SUPREME COURT’S APPROACH IN JONES

The Supreme Court granted certiorari to Jones v. Harris Associates L.P. and rendered a decision in 2010. In an opinion delivered by Justice Alito, the Supreme Court overturned the decision of the Seventh Circuit and reinstated the Gartenberg approach as the correct interpretation of the “fiduciary duty” set forth in section 36(b).

In making its decision, the Supreme Court reviewed the legislative history of section 36(b) and recognized that the purpose of implementing the amendment was to strengthen the remedy available to shareholders to redress unreasonable fees charged by fund managers. Before section 36(b) was put into place, the Supreme Court noted, shareholders challenging fees charged by investment advisers were forced to meet state law requirements of corporate waste, under which a fee would not be disapproved unless it was “unconscionable” or “shocking.” Recognizing that the earlier forms of section 36(b) included a “reasonableness” standard rather than a “fiduciary duty” standard, the Court concluded that the

96. Id.
97. Id. at 635.
99. Id. at 729.
100. Id. at 730.
102. Id. at 1430–31.
103. Id. at 1423.
104. Id.
“fiduciary duty” standard that was ultimately adopted was a result of the objections of industry representatives who feared that a “reasonableness” standard might give the SEC ratemaking authority.\textsuperscript{105} Because of this compromise, the Court concluded that the standard adopted was more favorable to shareholders than previous remedies but still did not allow courts to review rates for “reasonableness.”\textsuperscript{106}

The Court failed to take a side in the debate over whether the “fiduciary duty” under section 36(b) should be governed by the law of trusts.\textsuperscript{107} Instead, the Court looked to a formulation that it had arrived at in a previous case involving a dominant shareholder’s claim for compensation from a bankrupt corporation.\textsuperscript{108} Analogizing fund managers to dominant shareholders, both of which, the Court held, are fiduciaries whose powers are held in trust, the Court explained:

Their dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein. . . . The 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.\textsuperscript{109}

The Court believed that this expressed the meaning of “fiduciary duty” under section 36(b), and that the Investment Company Act modified this by switching the “burden of proof from the fiduciary to the party claiming breach.”\textsuperscript{110}

The Court upheld Gartenberg’s holding that all relevant circumstances should be taken into account when considering whether a breach has occurred and recognized that approval of fee levels by disinterested directors, in conjunction with shareholder suits under section 36(b), is “the cornerstone of the . . . effort to control conflicts of interest within mutual funds.”\textsuperscript{111} The Court held that the amount of weight that should be given to approval by disinterested directors should be determined by the court and would depend on the directors’ expertise, their knowledge

\textsuperscript{105} Id.
\textsuperscript{106} Id.
\textsuperscript{107} Id. at 1427.
\textsuperscript{108} Id. (referencing Pepper v. Litton, 308 U.S. 295 (1939)).
\textsuperscript{109} Id. (quoting Pepper, 308 U.S. at 306–07).
\textsuperscript{110} Id.
\textsuperscript{111} Id. (quoting Burks v. Lasker, 441 U.S. 471, 482 (1979)) (internal quotation marks omitted).
of the facts, and the amount of care with which they perform their duties.\footnote{112}{Id. at 1428.}

Although the Court advocated giving additional deference to decisions made by boards who consider all relevant factors, the Court recognized that the fee approved could still be excessive and could be examined to see if it is disproportionately large and not the product of arm’s-length bargaining.\footnote{113}{Id. at 1429–30.} The Court, however, rejected judicial second-guessing of informed board decisions by utilizing any sort of “reasonableness” analysis because “courts are not well suited to make such precise calculations” and required that courts find “additional evidence that the fee exceed[ed] the arm’s-length range” before a court may “supplant the judgment of disinterested directors apprised of all relevant information.”\footnote{114}{See also General Motors Corp. v. Tracy, 519 U.S. 278, 308 (1997) (“[T]he Court is institutionally unsuited to gather the facts upon which economic predictions can be made, and professionally untrained to make them.”).}

The Court rejected any categorical rule allowing comparisons between fees that an adviser charges a captive mutual fund and fees that the adviser charges independent clients.\footnote{115}{Jones, 130 S. Ct. at 1428–29.} Instead, the Court held that courts could determine the weight to be given to such a comparison based on all the surrounding circumstances.\footnote{116}{Id.} The Court also warned that courts should not rely too much on comparisons between the fees charged by different advisers because the other fees may not be the product of arm’s-length bargaining.\footnote{117}{Id. at 1429.}

The Court settled the debate between the Seventh Circuit panel and the dissent of Judge Posner by upholding the Gartenberg approach and noting that such a debate was better suited for Congress than the courts.\footnote{118}{Id. at 1430–31.} The Court vacated the holding of the Seventh Circuit and remanded the case for further proceedings.\footnote{119}{Id. at 1431.}

\textbf{D. THE PROBLEM WITH THE GARTENBERG APPROACH AND THE SUPREME COURT’S APPROACH IN JONES}

The problem with the approaches taken by the court in Gartenberg and the Supreme Court in Jones is that they both relied on a muddled, contradictory legislative history, and they both force courts to conduct a
“reasonableness” analysis that, by the Supreme Court’s own concession, courts are not properly equipped to do. The reasonableness standard set forth in both cases is absolutely useless if courts are unable to apply it. Although the Supreme Court expressly rejected any sort of judicial second-guessing by way of a “reasonableness” analysis, the Court stated 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,” and, under the Supreme Court’s approach, a court can inquire into whether a fee is “disproportionately large.” The semantic difference between a “reasonableness” analysis and an inquiry into whether the “transaction carries the earmarks of an arm’s length bargain” or is “disproportionately large” should provide little comfort to those worried that courts are not properly equipped to make such determinations, especially when the Supreme Court has its own doubts.

Most importantly, as Judge Posner noted in his dissent to Jones, “[s]ubsequent litigation [after Gartenberg] in excessive fee cases has resulted almost uniformly in judgments for the defendants.” As long as courts must continue to fumble with the Gartenberg method, shareholders will most likely be denied the protection that section 36(b) was enacted to provide for them, as they have been since the Second Circuit first ruled in Gartenberg.

E. THE PROBLEM WITH JUDGE EASTERBROOK’S APPROACH IN JONES

Judge Easterbrook’s approach in Jones is also problematic. Not only did Easterbrook’s opinion rely on the same unclear legislative history of section 36(b) that the Gartenberg court relied on, but the opinion also chose sides in an economic debate that is by no means settled. Although Judge Easterbrook’s opinion provides a much more workable standard than

120. Id. at 1430 (“[C]ourts are not well suited to make such precise calculations.”).
121. Id. at 1427 (emphasis omitted) (quoting Pepper v. Litton, 308 U.S. 295, 306–07 (1939)) (internal quotation marks omitted).
122. Id. at 1429 (quoting Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 694 F.2d 923, 928 (2d Cir. 1982)).
124. Of course, there is the unlikely possibility that since the court ruled in Gartenberg no shareholder has brought a legitimate claim under § 36(b), but whether this is the case or not, it is important that, when a shareholder does bring a legitimate claim, the court addressing the problem has a standard that they are capable of applying to ensure that the shareholder is protected.
125. See supra text accompanying notes 94–96.
126. See infra Part V.
the Gartenberg approach in that it only calls on a court to conduct an analysis of whether any sort of deception took place,\(^\text{127}\) its reliance on unsettled hypotheses could render section 36(b) absolutely useless if, in fact, competition in the mutual fund industry is not sufficient to restrain advisers’ fees, as many academics contend.\(^\text{128}\) And, of course, since the Gartenberg approach provided very little protection to shareholders, as evidenced by the absence of plaintiffs’ victories in section 36(b) cases, Judge Easterbrook’s approach would be sure to strip shareholders of whatever protection remained under Gartenberg because of the additional leeway it gives to fund advisers.

It could be argued that Judge Easterbrook’s approach in Jones would lead shareholders to be more vigilant in monitoring the activities of their fund adviser and to switch funds based on the performance or fee of their current fund adviser. Studies, however, suggest that this may not be the case. A study conducted by Forbes Magazine revealed that 84 percent of the investors surveyed believed that higher fund expenses resulted in higher performance by the fund.\(^\text{129}\) As James D. Cox and John W. Payne pointed out in their article analyzing mutual fund expenses from a behavioral perspective, “[t]o students of the mutual fund industry, this statistic is a bit like saying higher maintenance charges are associated with better performing automobiles.”\(^\text{130}\) A study published in the Journal of Finance revealed that investors often act irrationally in their choice of funds because marketing tactics employed by poorly performing funds heavily influence investors’ decisions.\(^\text{131}\) The study concluded that the result of such behavior was that new entrants into the mutual fund market had significantly higher fees than existing funds, and funds that ranked in the bottom decile in returns grew at an annual rate of 20.5 percent, whereas low cost funds grew at an annual rate of only 11.8 percent.\(^\text{132}\) The authors of the study noted that, “[i]n such a market, all that is necessary for inferior funds to exist and grow is a set of uninformed investors and a set of distributors who have an economic incentive to sell inferior products.”\(^\text{133}\)

The findings of this study are even more troubling when coupled with the

\(^{127}\) See supra text accompanying notes 88–93.

\(^{128}\) See infra Part V.A.


\(^{132}\) Id. at 286.

\(^{133}\) Id.
fact that “index funds may be particularly attractive to sophisticated investors who suspect that active management does not add value”\textsuperscript{134} because “as we move from index funds to funds with more active management we are likely not only to find higher operating costs but also to find even less sensitivity to operating costs on the part of investors.”\textsuperscript{135} Thus, given the types of investors who place their money in actively managed mutual funds that are subject to unreasonable adviser fees, there is a chance that Judge Easterbrook’s approach will not motivate investors to be more diligent in their fund selection and will not provide the protection that section 36(b) intended these shareholders to receive. This Note asserts that when it comes to assumptions about which there is considerable doubt, it is better to err on the side of caution to ensure that investors are actually protected by section 36(b), and that the statute is not rendered completely useless.

V. DIFFERING OPINIONS OVER THE SUFFICIENCY OF RESTRAINTS ON ADVISERS’ FEES IN THE MUTUAL FUND INDUSTRY\textsuperscript{136}

As is evident from the analyses done by both Congress and the courts, the issue of whether competition among mutual funds and other forces at play within the mutual fund industry is sufficient to restrain managers’ fees is important to any investigation of a section 36(b) claim. It is not entirely clear, however, how this issue should be resolved, as studies come down on both sides of the matter.

A. THE ARGUMENT AGAINST SUFFICIENT RESTRAINTS IN THE FUND INDUSTRY

The original basis for amending the Investment Company Act of 1940 with section 36(b) was the Wharton Report, commissioned in the 1950s, which found that fees paid to investment advisers for their work did not correlate with the cost of performance of their services or to investment

\textsuperscript{134} Paul G. Mahoney, Manager-Investor Conflicts in Mutual Funds, 18 J. ECON. PERSP. 161, 171 (2004).

\textsuperscript{135} Cox & Payne, supra note 130, at 911.

\textsuperscript{136} It is important to note that the purpose of this portion of the Note is not to convince readers to side with one view of market forces in the mutual fund industry over another view—this is beyond the scope of the Note and irrelevant to its final conclusions. The purpose of this part of the Note is merely to show that strong arguments exist on both sides of the issue and there is no general consensus over whether advisers’ fees can be restrained by market forces alone. It is also important to note that this is by no means an exhaustive review of the literature on the subject, but it is enough to demonstrate that solid arguments exist on either side.
results and doubted that arm’s-length negotiation was present in the mutual fund industry. \(^{137}\) The SEC released a report with similar findings in 1966. \(^{138}\) The Gartenberg court based its conclusion that the fund industry lacks sufficient competition \(^{139}\) mainly on the SEC Report issued in 1966, and the Supreme Court in Jones relied on this conclusion by the Gartenberg court and Judge Posner’s dissent in the Seventh Circuit’s denial of a rehearing en banc of Jones, in which Judge Posner also doubted the presence of sufficient competition in the mutual fund industry to restrain advisers’ fees, \(^{141}\) to support its holding. \(^{142}\)

Judge Posner based his doubt on an analogy between the fund industry and the system of executive compensation in corporations. \(^{143}\) According to Posner, boards of directors lack incentives to police compensation because directors are often executives of other companies who believe that executives deserve to be paid well. \(^{144}\) Thus, Posner concluded, the role of the board of directors is essentially muted as a force to restrain advisers’ fees. \(^{145}\) Judge Posner also observed that “[a]s 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.” \(^{146}\) Therefore, Posner argued, allowing a comparison to fees charged by other funds would allow exorbitant fees to become the industry’s floor, assuming the problem of exorbitant fees is industry wide. \(^{147}\)

In addition to the courts, many academics have expressed doubt about the sufficiency of competition and other forces in the fund industry to

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\(^{137}\) See supra text accompanying notes 31–35.

\(^{138}\) See supra text accompanying notes 36–38.

\(^{139}\) Utilizing information from the report, the Gartenberg court came to the conclusion that competition between funds for the business of shareholders does not support the conclusion that competition between advisers for fund business must also be rigorous because different forces govern each. Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 694 F.2d 923, 929 (2d Cir. 1982). Because a fund cannot easily switch advisers, competition between advisers to manage other funds is low. Id. Thus, the court concluded reliance on industry fees alone could not satisfy § 36(b) because advisers do not have motivation to restrain their fees when they lack the threat of being replaced. Id. Finally, the Gartenberg court asserted that if market forces in the fund industry were sufficient to restrain managers’ fees, there would be little purpose in § 36(b). Id.

\(^{140}\) See id. at 929–30; supra text accompanying notes 36–38.


\(^{143}\) Jones, 537 F.3d at 730 (Posner, J., dissenting).

\(^{144}\) Id. (citing Ben Stein, In the Boardroom, Every Back Gets Scratched, N.Y. TIMES, Apr. 6, 2008, at B9).

\(^{145}\) Id.

\(^{146}\) Id. at 731–32 (quoting John P. Freeman & Stewart L. Brown, Mutual Fund Advisory Fees: The Cost of Conflicts of Interest, 26 J. CORP. L. 609, 634 (2001)).

\(^{147}\) Id. at 732.
restrain the fees charged by fund managers. A study by John P. Freeman and Stewart L. Brown analyzed the fund industry and revealed that while economies of scale operate in the fund industry and cause fund operating expenses to decline as a fund’s size grows, these economies are not passed on to shareholders through a reduction in advisers’ fees, which causes a depletion in shareholder wealth. The study concluded that the fund industry’s contention that price competition exists in the industry is supported only by “selectively presented data.” The authors asserted that bundling administrative expenses and advisers’ fees into one expense ratio misleads shareholders given that the expense ratio declines as funds grow in size, but the decline stems from a decrease in administrative expenses rather than a decrease in advisory fees. Further, advisers fail to pass on the economies to shareholders and instead reap the benefits themselves. Because price competition is evidenced by the actions of the producers, rather than the consumers, the authors concluded that price competition in the fund industry is weak.

An article by John Morley and Quinn Curtis argues that the ability of shareholders in mutual funds to redeem their shares from the issuing funds for cash, rather than having to sell their shares, creates a uniquely effective form of exit that almost completely eliminates the incentives of mutual fund investors to become active in the fund to regulate the actions of advisers, including fee increases. Additionally, the study concludes that exit interacts with fee liability to discourage investors from moving to lower fee funds, assuming any are available. The logical result of such a finding is that investor action is currently insufficient to restrain advisers’ fees, and that investor departure, which could spur competition among fund managers, is repressed.

A 2009 study by Camelia M. Kuhnen, a Northwestern University professor, examined the futility of mutual fund boards in restraining

149. Freeman & Brown, supra note 148.
150. Id. at 624–27.
151. Id.
152. Id.
153. Id.
155. Id.
advisers’ fees and proposed the possibility that

[T]he agents who serve fund investors—namely, fund directors and managers—are very much connected through business interactions. These strong business ties may cause . . . conflicts of interest . . . by fostering favoritism between directors and the fund management to the detriment of investors . . . [This] favoritism can manifest when directors negotiate the management fees with the fund’s primary advisor (the entity that offered them the board seats) . . . . 156

Additionally, as mentioned above, studies have shown that shareholders invested in mutual funds often act irrationally and are strongly affected by the marketing ploys of low performing funds. 157 This causes the growth of these low performing funds and skews the usual effect of competition, which is the demise of low performing funds with high fees. 158 Thus, many scholars contend that both price competition and internal forces within the mutual fund industry fail to restrain advisers’ fees.

The U.S. General Accounting Office released a report in 2000 that also expressed concern about whether competition in the fund industry sufficiently restrains advisers’ fees. 159 The report cited to other studies and analyses that suggested fees in the mutual fund industry are rising and that directors may be keeping fees at higher levels to keep them in range of the fees charged by other funds. 160 The general conclusion of the report was that price competition does not exist in the fund industry. 161

B. THE ARGUMENT FOR SUFFICIENT RESTRAINTS IN THE FUND INDUSTRY

The debate over whether forces in the fund industry are sufficient to restrain advisers’ fees is by no means settled, and many contend that such forces alone are sufficient to achieve such a result. One of the biggest proponents of this contention is Judge Easterbrook, who wrote the Seventh Circuit’s decision in Jones. 162 The main thrust behind Judge Easterbrook’s

156. Kuhnen, supra note 148, at 2186, 2219 (while Kuhnen does explore this concept, her ultimate conclusion is that while “[t]he strength of advisor-board connections is positively correlated with fund expense ratios and management fees . . . these effects are not robust to all specifications and their economic magnitude is small.”).
157. See supra text accompanying notes 129–35.
158. Id.
160. Id. at 9, 47.
161. Id. at 62–65.
162. Jones v. Harris Assocs. L.P., 537 F.3d 627, 629 (7th Cir. 2008), vacated, 130 S. Ct. 1418
argument came from the assertion that the findings of the legislature when section 36(b) was passed, based on the Wharton Report and the 1966 Report of the SEC, are now outdated because of a tremendous growth in the mutual fund industry.\textsuperscript{163} This growth, Easterbrook argued, allows investors to freely choose funds when a manager’s fee seems excessive to the investor based on the results the investor is achieving from the mutual fund.\textsuperscript{164} Because investors possess the ability to easily switch between funds, Easterbrook argued funds must offer fees that are not excessive or they will drive away all investors, and an adviser cannot make money from a fund without investors.\textsuperscript{165}

Judge Easterbrook is not alone in his belief that forces in the fund industry are sufficient to curtail adviser fees—studies conducted by academics also support such an argument.\textsuperscript{166} D. Bruce Johnsen authored an article in which he assessed the Seventh Circuit’s decision in \textit{Jones} and strongly supported Judge Easterbrook’s rule.\textsuperscript{167} The article dispels several “myths” about the mutual fund industry that, once corrected, support Easterbrook’s ruling because, according to Johnsen, shareholders’ perceptions that advisers’ fees are excessive and are not controlled by forces within the mutual fund industry are a result of these misperceptions about the industry, rather than any actual abuse on the part of fund advisers.\textsuperscript{168} One “myth” that the author dispels is that “a reduction in advisory fees will increase investor returns dollar-for-dollar.”\textsuperscript{169} This is untrue, according to Johnsen, because the open structure of mutual funds will cause any additional returns resulting from a manager’s skill to be competed away by investors seeking to capture such returns.\textsuperscript{170} Another “myth” dispelled by Johnsen is that economies of scale cause the costs of fund management to decline as a fund increases in size and that these scale economies should be passed on to shareholders through lower advisers’ fees.\textsuperscript{171} Johnsen refutes this by arguing that scale economies result from a

\begin{itemize}
\item \textsuperscript{163} Id. at 633–34.
\item \textsuperscript{164} Id.
\item \textsuperscript{165} Id. at 632.
\item \textsuperscript{167} Johnsen, supra note 166, at 563.
\item \textsuperscript{168} Id. at 563–66.
\item \textsuperscript{169} Id. at 564.
\item \textsuperscript{170} Id. (stating that “[n]o public investor can expect to capture a share of any fee reduction in the form of higher investment returns,” and those that believe lower fees will cause a dollar-for-dollar increase in investors’ returns are mistaken).
\item \textsuperscript{171} Id.
\end{itemize}
decrease in the average per-unit cost of production of an economic good as output of that good increases, but in the case of mutual funds, “assets-under-management” is not something that investors demand. And it is not what fund advisers produce.172 According to Johnsen, a reduction in average management cost as the size of a fund grows does not alone justify the conclusion that advisers’ fees should also decrease because such a conclusion requires an economic analysis of the theory of contract choice that is absent from the analyses of those drawing this conclusion.173 The final “myth” dispelled by Johnsen is that the fees charged to institutional investors are an appropriate comparison for the fees charged to individual investors.174 The author refutes this by arguing that individual investors do not, either as a result of irrationality or inability, assess fees when choosing in which fund to place their money, while institutional investors do assess manager quality because they are able to do so at a much lower cost.175 The reason shareholders are charged higher fees, according to Johnsen, is so that higher quality managers can easily differentiate themselves from other managers—meaning that the higher fees are a market force that assures higher quality to imperfectly informed investors, rather than an expropriation of shareholder wealth.176 After dispelling these “myths,”177 the article concludes by stating that Judge Easterbrook’s rule is “the only economically sensible way to understand section 36(b)’s fiduciary standard.”178

A 2007 article written by John C. Coates IV and R. Glenn Hubbard also supports Judge Easterbrook’s belief that competition in the fund industry is sufficient to curtail advisory fees.179 The authors begin their analysis by presenting data representing the vast increase in the number of mutual funds since 1985, and the authors observe that this increase in

172. Id. at 565.
173. Id.
174. Id.
175. Id.
176. Id.
177. In addition to the myths described above, Johnsen also dispels the “myth” that shareholders own the fund’s investment returns and are therefore entitled to share in any returns that accrue to the manager as a result of the manager’s superior stock picking skills. Id. at 563–64. Johnsen argues that this assumption is untrue because mutual funds are subject to free investor entry and exit, and the additional returns stemming from the manager’s superior ability are nonexclusive rents for which fund shareholders must compete by buying shares and paying the associated management fee. Id. at 564. Because of this structure, the author argues, fund shareholders own a pro rata share of existing net assets but do not have an exclusive claim to future investment returns that result from the manager’s skill. Id.
178. Id. at 614.
179. Coates & Hubbard, supra note 166, at 151.
choice has led to an increase in competition.\textsuperscript{180} The authors support this contention by showing low Herfindahl-Hirschman Indexes (“HHI”) for funds in the industry, indicating values consistent with competition.\textsuperscript{181} According to the authors, “the structure of the mutual fund industry, with thousands of funds and hundreds of investment advisers competing for investors, implies effective price competition,” and the “view that all fund complexes select not to compete on price, when price competition can gain new customers and increase adviser profits, is economically unfounded.”\textsuperscript{182} The authors continue by analyzing the number of new entrants to the mutual fund market to support their contention that barriers to entry are low, which also facilitates competition.\textsuperscript{183} The authors also present evidence to show that the large number of distribution channels in the fund industry promotes competition because competition for investor business exists within each channel and shareholders have access to a large number of options.\textsuperscript{184} Finally, the authors analyze both the trends in fees and expenses and the changes in market share to support their conclusion that competition exists within the mutual fund industry.\textsuperscript{185} The authors observe that their analysis of fees and expenses indicates conflicting results in the trends of average expense ratios, rather than an increase in these ratios as their opponents have found.\textsuperscript{186} The authors attribute these results to the time period analyzed, the way expense ratios are measured, and the sample of the funds, and they conclude that the overall results of studies of expense ratios are consistent with price competition.\textsuperscript{187} The authors reach the same conclusion in their study of changes in market share because the market share of successful funds grew more than rival funds, thus indicating competition among the funds.\textsuperscript{188} Based on these findings, the authors concluded that “[f]und performance is consistent with competition exerting a strong disciplinary force on funds and fees.”\textsuperscript{189}

\textsuperscript{180} Id. at 164.
\textsuperscript{181} Id. at 165.
\textsuperscript{182} Id. at 167.
\textsuperscript{183} Id. at 167–68.
\textsuperscript{184} Id. at 170–71 (stating that these channels include “(1) direct sales, (2) retirement plans, (3) full-service financial firms, (4) fund supermarkets and discount brokers, and (5) direct sales to institutional investors” (footnotes omitted)).
\textsuperscript{185} Id. at 174–80.
\textsuperscript{186} Id. at 174–75.
\textsuperscript{187} Id. at 175, 177.
\textsuperscript{188} Id. at 178–79.
\textsuperscript{189} Id. at 151.
VI. POTENTIAL SOLUTIONS TO THE PROBLEM OF EXCESSIVE COMPENSATION FOR FUND ADVISERS

A. EXECUTIVE COMPENSATION COMPARED TO FUND ADVISER COMPENSATION

It is almost impossible not to draw comparisons between executive compensation in publicly traded corporations and the fees charged by fund advisers. Such a comparison was made by Judge Posner in his dissent to the Seventh Circuit’s opinion in *Jones* as well as Judge Easterbrook in his decision in *Jones*. The comparison is only logical to make, as both executives in publicly traded corporations and fund advisers have the purpose of creating value for the shareholders, both are compensated in an amount that can be approved by a board of directors, and, most importantly, both have been criticized for receiving excessive compensation. A number of potential solutions have been proposed to curb the excesses present in the market for executive compensation, but none of the proposals, alone, would provide the best solution if applied to fund advisers. In addressing each solution, it is important to remember that mutual funds and publicly traded corporations are not identical, so the reasons that some of the solutions may not work in the context of a mutual fund will differ from why they may or may not work in the context of a publicly traded company.

One commonly proposed solution to control the level of executives’ pay is the “say on pay” solution. Under a say on pay framework, the

192. See, e.g., Freeman & Brown, *supra* note 148, at 672 (contending that fund advisers are overpaid because their fees are unrestrained); Arthur Levitt, Jr., *Corporate Culture and the Problem of Executive Compensation*, 30 J. CORP. L. 749, 749–50 (2005) (contending that executives in publicly traded corporations are overpaid).
193. Executives in publicly traded companies have a very different function than mutual fund advisers. Executives control the operation of their company, which in turn affects the value of the company’s stock. On the other hand, mutual fund advisers manage stocks that represent the value of a company that someone else is managing, and the adviser has no control over the underlying value of the companies, the aggregate of which determines the value of each share in a mutual fund. This inherent difference in function creates different incentives for each, and this, in turn, affects the type of pay structure available to each. For example, while executives in publicly traded companies can be compensated in a way that incentivizes them to operate a company in a way that will increase the long-term growth in its value, such as through stock options exercisable at some point in the future, such payment structures are inapplicable to mutual fund advisers.
shareholders of a corporation have the right to vote on the compensation of executives, though the vote is generally nonbinding.\textsuperscript{195} Similarly, if this method were applied to mutual funds, the shareholders would be able to vote on the compensation of the fund adviser. The issue with implementing say on pay in the mutual fund setting, however, is that the average investor is no more equipped than a court of law to make a decision about what is “reasonable” compensation for a fund adviser.\textsuperscript{196} This could result in either the shareholders trusting the opinion of the independent board members, which would leave advisers’ compensation in the same place that it would have been had say on pay not been implemented, or it could result in knee-jerk reactions by shareholders that result in unfavorably high or low compensation to advisers that is not based on their performance or effort, but instead based on mere market fluctuations that an adviser cannot control.

Caps on the amount of compensation that an executive can legally receive have also been proposed,\textsuperscript{197} but this will not provide the best answer to the problem of fund adviser compensation either. While this would keep fund advisers from bilking the shareholders with excessive fees, it would also limit the quality of service available to investment fund shareholders—the reasonableness of a fee is determined not by some arbitrarily picked number, but instead it is determined in relation to the services provided by the fund manager.\textsuperscript{198} Setting too low of a cap on the level of compensation that an adviser can receive would just be capping the quality of services that a shareholder can receive. The selection of where to place the cap on fees would require a difficult analysis, as it would have to

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shareholders-gain-more-frequent-say-on-pay-westlaw-business/
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\textsuperscript{196} See \textit{Jones v. Harris Assocs. L.P.}, 130 S. Ct. 1418, 1430 (2010) (noting that “courts are not well suited to make such precise calculations”). It follows logically that if courts are not able to make such a determination, the average investor is probably not able to either.
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\textsuperscript{198} See supra text accompanying note 41 (noting that the SEC’s report to Congress advocated that reasonableness should be determined by the nature of the services provided, the quality of the services, the value of the benefits received by the adviser, and any other relevant factors); \textit{Jones v. Harris Assocs. L.P.}, 527 F.3d 627, 634 (7th Cir. 2008) (Judge Easterbrook noted that “sophisticated investors choose to pay [hedge fund managers] substantially more for investment advice than advisers subject to § 36(b) receive.”), \textit{vacated}, 130 S. Ct. 1418 (2010). \textit{But see} Elton, Gruber & Blake, supra note 9, at 813–14 (suggesting that offering an incentive fee to managers for outperforming some benchmark does not, on average, cause managers to beat the benchmark by achieving higher returns).
\end{quote}
take into account the services provided by every fund in the industry, and, to ensure that the cap is not too low, it would have to be set at a level that accounts for the highest level of services provided by a fund adviser. Because of this, the cap would do very little to prevent unreasonable fees charged by fund advisers because those providing a level of services below the highest level could still charge fees as high as the cap, but the fee would be unreasonable in relation to the services provided.

B. DISCLOSE OF ADVISERS’ FEES

Disclosure has been suggested as a solution in the context of executive pay in publicly traded companies\(^\text{199}\) and warrants its own discussion as a solution to the problem of excessive advisers’ fees. By disclosing executives’ salaries in a publicly traded company, shareholders are able to determine whether they think that the level of compensation is fair, or if they would rather invest in another company. Although the fee amounts charged by mutual funds are widely distributed, the actual fee amount paid to the fund’s adviser is not.\(^\text{200}\) Disclosing the adviser’s fee in a mutual fund could result in similar decisions by shareholders—if they find the fee unfair, they could choose not to invest with that adviser. This alone, however, will not be enough to restrain advisers’ fees because, if the critics of fair competition in the mutual fund industry are correct, there will be no other place for shareholders to go with their money if all advisers’ fees are unreasonably high.\(^\text{201}\) Therefore, disclosure could be a useful tool, but only if investors have someplace else to go with their money.

The argument could be made that once disclosure occurs, fund advisers will have an incentive to advertise fees below their peers, attracting investors from other funds, thus allowing competition to occur and ensuring that fees stay at reasonable levels. This would only occur, however, if investors in the mutual fund industry were to act rationally, and this assumption cannot be made lightly, as there is evidence pointing to the contrary—investors in mutual funds are generally not sophisticated, leading to a mistaken belief about the level of an adviser’s fees in relation to the performance of a fund and to irrational decisions based on the marketing


\(^{200}\) Jones v. Harris Assocs. L.P., 527 F.3d 627, 631 (7th Cir. 2008), vacated, 130 S. Ct. 1418 (2010).

\(^{201}\) See supra text accompanying notes 143–47.
ploy of poorly performing funds. Therefore, although disclosure may be a good start, it is by no means the solution.

In addition to these problems, a disclosure requirement could see resistance from the industry, as section 36(b) did when it was first considered. The issue of industry resistance will be addressed in Part VII of this Paper as it relates to the Paper’s final proposal to solve the problem created by section 36(b).

C. OTHER POTENTIAL SOLUTIONS

Some scholars have suggested that either the Second Circuit’s approach in Gartenberg or the Seventh Circuit’s approach in Jones is the proper solution to define “fiduciary duty” under section 36(b) and to solve the problem of excessive compensation for fund advisers, and these opinions have been addressed above. Worth mentioning in addition to these methods is a Comment written in 2010 by Colin B. Davis in which he advocates implementing certain “penalty default rules” as a means of solving the problem of excessive compensation of fund advisers. Davis believes that a viable solution would be to have the SEC use its rulemaking authority to set a default advisory fee level towards the low end of the market. This, the author contends, would “remedy the disparity in bargaining power that exists between the investment adviser and the mutual fund’s board of directors and produce advisory fee structures more in line with the fair market value of advisory services.” This could provide a solution to the problem, if the issue was the lack of arm’s-length negotiation between the fund adviser and the board of directors. If, however, the issue is cronism occurring between fund advisers and the

202. See supra text accompanying notes 130–36. But see supra text accompanying notes 174–75 (asserting that higher-quality fund advisers use higher fees to differentiate themselves from lower-quality advisers, allowing investors with limited resources to place their money in the correct fund without having to do an in-depth assessment of the fund). Again, this Note does not contend that one side of this debate is correct and one side is incorrect. Instead, because there is no consensus on the issue, this Note asserts that it is better to assume that shareholders are not protected with the current status quo of the fund industry when considering solutions to the problems.

203. See supra text accompanying notes 43–47.

204. See, e.g., Johnsen, supra note 166, at 614 (asserting that Judge Easterbrook’s approach in Jones is the proper solution); Yeung & Freeman, supra note 34, at 512 (asserting that the Gartenberg approach is the proper solution).

205. See supra Part IV(D)–(E).


207. Id. at 212.

208. Id.
board of directors, as Judge Posner observed in his dissent in Jones, \textsuperscript{209} the adviser and the board of directors would have no trouble reaching a new fee level well above the penalty default level, and shareholders would be in the same position that they would have been without the default rules.

VII. TURNING TO AN UNEXPECTED AREA OF LAW: A PROPOSED SOLUTION TO THE PROBLEM OF EXCESSIVE COMPENSATION FOR FUND ADVISERS

A. A BRIEF RECAPITULATION OF THE CURRENT PROBLEMS WITH SECTION 36(B)

The clear root of the problems that have stemmed from section 36(b) of the Investment Company Act of 1940 are the result of Congress’s failure to define “fiduciary duty” as it is used in the law. An examination of the legislative history of section 36(b) reveals that no clear consensus about the definition existed when the amendment was passed, leaving courts without a clear meaning of the change from a “reasonableness” standard to a “fiduciary duty” standard. \textsuperscript{210}

As a result of this lack of clarity, the courts have also had difficulty arriving at a definition of “fiduciary duty” under section 36(b). In Gartenberg and Jones, the courts relied on the volatile legislative history of section 36(b), \textsuperscript{211} and Judge Easterbrook’s opinion in Jones relied on one side of an economic debate that is hardly settled. \textsuperscript{212}

It is not difficult to ascertain why relying on the legislative history of section 36(b) or on an economic analysis of the mutual fund industry can lead courts to decisions that are so drastically different from one another. The legislative history of section 36(b) is far from clear, and support can be found for both the Gartenberg approach and Judge Easterbrook’s approach in Jones. \textsuperscript{213} Additionally, an economic analysis of competition in the fund industry can support either Judge Easterbrook’s opinion in Jones or Judge Posner’s dissent from Jones because scholars have not reached any sort of consensus on whether competition in the fund industry is sufficient to restrain advisers’ fees. \textsuperscript{214}

\textsuperscript{209} See supra text accompanying notes 143–147.
\textsuperscript{210} See supra text accompanying notes 48–64.
\textsuperscript{211} See supra text accompanying note 120.
\textsuperscript{212} See supra text accompanying note 126.
\textsuperscript{213} See supra Part III.
\textsuperscript{214} See supra Part V.
As it currently stands, the Supreme Court adopted an approach to addressing section 36(b) claims that courts are unable to apply, thus rendering the standard useless. It is unclear whether competition in the mutual fund industry is sufficient to restrain advisers’ fees, making it necessary for fees to be reviewed for some sort of reasonableness, lest they spiral out of control and continue to increase as they have been. At the same time, courts are ill equipped to do such an analysis. This means that some governing entity other than the courts must be charged with this duty.

B. THE EQUAL EMPLOYMENT OPPORTUNITY COMMISSION

In 1964, Congress passed the Civil Rights Act of 1964 and authorized the creation of the Equal Employment Opportunity Commission ("EEOC"), which was subsequently formed on July 2, 1965. The EEOC consists of five members appointed by the President, and no more than three of the members can be members of the same political party. The EEOC is empowered “to prevent any person from engaging in any unlawful employment practice” as set forth under the Act.

The essential purpose of the EEOC is to enforce violations of the provisions set forth in Title VII of the Civil Rights Act of 1964. When an individual wishes to assert a claim under the Civil Rights Act of 1964, the person must first file a complaint with the EEOC. The EEOC then inquires into the truth of the charge and if there is not reasonable cause to believe that the charge is true, the EEOC will dismiss the complaint. If, however, the EEOC finds the charge to be reasonable, it will attempt to eliminate the unlawful practice by means of “conference, conciliation, and persuasion” in a meeting with the employer. In the event that these methods fail, the EEOC is authorized to bring a civil action against the employer to force compliance with the law.

215. See Freeman, Brown & Pomerantz, supra note 148, at 90–91 (observing that “in less than three decades, annual payments to fund sponsors and service providers have increased by an astonishing factor of sixty times” (emphasis omitted)).
217. § 2000e-4(a).
218. § 2000e-5(a).
219. Id.
220. § 2000e-5(b).
221. Id.
222. Id.
The EEOC has been extremely successful in enforcing the provisions of the Civil Rights Act of 1964. A five-year study released in 2002 revealed that approximately 91 percent of federal employment discrimination lawsuits brought by the EEOC during this period were “successfully resolved through Consent Decrees, settlement agreements, and favorable court orders.”\textsuperscript{224} Additionally, the EEOC had a success rate at trial that was more than double that of private plaintiffs and an 80 percent success rate on appeals, as opposed to a 16 percent rate for private parties.\textsuperscript{225}

C. A PROPOSED SOLUTION

1. Fixing the Current Problem with Section 36(b)

Unfortunately, there is no way to revise the wording of section 36(b) to make it both workable by courts and able to protect investors. It is important to remember that the purpose of Congress enacting section 36(b) was to provide additional protection to investment fund shareholders.\textsuperscript{226} As Judge Posner aptly noted in his Jones dissent, however, “[s]ubsequent litigation []after Gartenberg[] in excessive fee cases has resulted almost uniformly in judgments for the defendants.”\textsuperscript{227} Whether this is because advisers’ fees are currently at reasonable levels or because the Gartenberg method does not provide adequate protection to shareholders because it is too difficult for courts to apply, it is imperative that section 36(b) is able to provide the protection to shareholders that Congress intended when the amendment was enacted in the event that advisers’ fees are not adequately restrained, as many contend. To do this, the standard used must be both workable and able to curb advisers’ fees—this cannot be accomplished by the courts, so it is important to delegate this duty to another governing body.

Taking a cue from the EEOC, either Congress or the SEC could use its authority to create a special committee composed of financial experts to enforce section 36(b).


\textsuperscript{225} Id.

\textsuperscript{226} See supra text accompanying notes 26–64.

\textsuperscript{227} Jones v. Harris Assocs. L.P., 537 F.3d 728, 730 (7th Cir. 2008) (Posner, J., dissenting) (quoting JAMES D. COX, ROBERT W. HILLMAN & DONALD LANGEVOORT, SECURITIES REGULATION: CASES AND MATERIALS 1211 (3d ed. 2001)).
2. The EEOC

Like the EEOC, the committee would be charged with assessing the reasonableness of a claim before commencing any sort of action. If the committee were to find truth behind the claim, it could first try to negotiate with the fund adviser and the fund’s board of directors to remedy the problem. If the committee and the fund are unable to reach a solution through negotiations, then the committee, like the EEOC, could be authorized to take the matter to court to force the fund to comply and to assess shareholder damages.

Appointments of financial experts to the committee could be done similarly to the appointments to the EEOC. The President appoints individuals to the EEOC and, to make sure that the commission stays bipartisan, the President is allowed to appoint no more than three individuals, of the five on the commission, who are part of the President’s political party.\footnote{228} Similarly, the President could appoint financial experts to the committee, but would be allowed to appoint only a certain number of individuals who are members of the same political party—this would vary depending on the number of financial experts on the committee. Although the political affiliations of the financial experts may be difficult to ascertain, the President would have to use discretion in the selection, and it may be helpful to require congressional approval of the President’s appointees, similar to the way Supreme Court justices are appointed.

In determining whether an individual that the President plans to appoint is actually a financial expert, the President could use the same standard used by federal courts to determine if an expert witness is actually an expert. Under Federal Rule of Evidence 702, a witness is determined to be an expert by virtue of the individual’s “knowledge, skill, experience, training, or education.”\footnote{229} According to the comments to this rule, it is broadly phrased and does not limit the meaning of “expert” to the strictest sense of the word.\footnote{230} Therefore, the President would have considerable leeway in selecting the individuals on the committee so long as there is some logical basis for the decision—appointees could be retired businessmen, professors, or any other individuals with the requisite skills to assess the validity of a section 36(b) claim.
3. Assessing Reasonableness

The committee could assess reasonableness using the considerations originally proposed to Congress by the SEC when section 36(b) was first considered, which included the nature of the services provided, the quality of the services, the value of the benefits received by the adviser, and any other relevant factors.\(^{231}\) Other relevant factors could include those observed by the Gartenberg court, which included

the profitability of the fund to the adviser . . . any “fall-out financial benefits,” those collateral benefits that accrue to the adviser because of its relationship with the mutual fund . . . comparative fee structure (meaning a comparison of the fees with those paid by similar funds) . . . and the independence, expertise, care, and conscientiousness of the board in evaluating adviser compensation.\(^{232}\)

The expertise possessed by members of the committee would enable them to appropriately factor each of these considerations to determine whether an adviser’s fee is reasonable.

4. Meeting Resistance

Like any government action that some perceive as being against their interest, or that others perceive as a needless expansion of the already bloated federal government, the new committee would not be implemented without opposition. Representatives from the mutual fund industry are likely to oppose the implementation of the new committee, much like the ICI opposed section 36(b) when it was first considered.\(^{233}\) These opponents, however, are also the same who would likely contend that market forces in the mutual fund industry are already sufficient to restrain advisers’ fees. If this is the case, this opposition will have nothing to fear, as the implementation of a new committee will not strengthen the language of section 36(b) in any way and if market forces are sufficient, then the committee will not have to bring any section 36(b) cases to court. The fact that a sophisticated, capable committee is implementing section 36(b) should quell the concerns of those who oppose the expansion of the federal government. For those who fear an expansion of the government, the thought of an arbitrary implementation of the law should be much more frightening than the creation of an additional committee. Additionally, the

\(^{231}\) See supra text accompanying note 41.


\(^{233}\) See supra text accompanying notes 43–47.
The benefit of this approach to section 36(b) claims is that it would give section 36(b) the ability to regulate advisers’ fees, as Congress intended, and it would also remove the duty of assessing reasonableness from the hands of courts. Instead of courts, the SEC’s committee would be tasked with assessing the reasonableness of an advisers’ fee in relation to the services provided. By staffing the committee with financial experts who are equipped to do such an analysis, a court could rely on the committee’s analysis of reasonableness if the committee were to bring the matter to court. This not only stands to provide investment fund shareholders with the protection that they need, but also would force an investment fund to negotiate with the committee before a case can be brought to trial, which could also reduce litigation. And, in the event that a case does end up at trial, the trial would be expedited by the committee’s prior determination of the unreasonableness of the adviser’s fee.

Like the EEOC, this committee has a high chance of success. The EEOC is able to reach favorable outcomes in approximately 91 percent of its lawsuits, and, given that this committee’s structure would largely mirror the structure of the EEOC, there is no reason that this committee cannot achieve the same success. Delegating the enforcement of section 36(b) claims to a special committee composed of financial experts has the ability to give section 36(b) the force that Congress intended it to have without choosing sides in an economic debate and without assigning an unmanageable task to the courts. If market forces are sufficient to keep advisers’ fees at reasonable levels, then the committee will rarely have to bring a case to court, and if they are not, then the committee is in place to protect shareholders as Congress intended.

Disclosure in Relation to this Proposal

As mentioned above, disclosure alone is not a viable solution to the current problem with section 36(b), but it could be a valuable addition to this proposal. If this proposal serves its function of keeping advisers’ fees at reasonable levels, then requiring disclosure will be of value to investors because it will allow them to choose between funds based on the fee.
charged by an adviser, and if the investor wants to switch funds, there should be other funds available that charge reasonable fees. This could have the additional benefit of decreasing the committee’s duties in litigating section 36(b) claims because it would allow investors to choose a fund wisely from the outset, rather than realizing the unreasonableness of an adviser’s fee after having been subjected to it, which would necessitate a section 36(b) claim. There is, however, still the chance that investors will act irrationally in their investment choices, but even if this is the case and an investor does not choose an ideal fund, the investor still would have the protection of section 36(b) to ensure that the fund, while maybe not ideal, is at least not charging unreasonable fees.

Implementing a disclosure requirement will likely run into opposition. If the proposed solution for a new committee to enforce section 36(b) is successful, however, such opposition is likely to be fairly weak because fund advisers will no longer have motivation to keep their fees secret as long as they are forced to keep the fees at reasonable levels. If anything, the advisers may then use their lower fees to their advantage in attracting new investors—if this marketing tactic is chosen over those that caused irrational behavior on the part of investors, then it is possible that the formerly irrational investors would then choose funds based on the advisers’ fee levels. The critical issue missing from the implementation of a disclosure requirement alone is the motivation of fund advisers to keep their fees secret when they are able to charge an unreasonable amount—if the adviser can no longer charge an unreasonable amount, that motivation is gone and disclosure can be effective.

VIII. CONCLUSION

As it stands, the Supreme Court has affirmed the Gartenberg standard for assessing section 36(b) claims—a standard that has afforded very little protection to investment fund shareholders. Although both the legislative history of section 36(b) and theories regarding the market forces at play in the mutual fund industry can be manipulated to support drastically different approaches to applying the “fiduciary duty” standard set forth under section 36(b), one thing is clear—Congress intended section 36(b) to provide additional protection to shareholders in investment funds. Although Judge Easterbrook’s approach in Jones is tempting to adopt because of the ease of its application, it also threatens to render section 36(b) completely useless.

236. See supra text accompanying notes 129–35.
237. Id.
With academics on either side of the issue of competition in the mutual fund industry, there is a very real possibility that Judge Easterbrook’s approach could fail to give shareholders the protection that Congress intended. Therefore, it is better to opt for overprotection of shareholders by assessing the reasonableness of advisers’ fees. This approach, however, risks increasing litigation and tasking courts with a job that they are not equipped to perform. Delegating the assessment of reasonableness to a committee of financial experts, however, will allow courts to avoid having to do any sort of reasonableness analysis and will provide investment fund shareholders with the protection that Congress intended when section 36(b) was enacted.