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Judge Not Under an Unjust Standard: Why an Investment Adviser's Fiduciary Duty as to Fees Under Section 36(B) of the Investment Company Act of 1940 is Illusory and Unjust until an Adjudicated Case Illustrates a Breach of the Fiduciary Duty

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ARTICLE

JUDGE NOT UNDER AN UNJUST STANDARD: WHY AN INVESTMENT ADVISER'S FIDUCIARY DUTY AS TO FEES UNDER SECTION 36(B) OF THE INVESTMENT COMPANY ACT OF 1940 IS ILLUSORY AND UNJUST UNTIL AN ADJUDICATED CASE ILLUSTRATES A BREACH OF THE FIDUCIARY DUTY

Tory L. Lucas†

I. INTRODUCTION

Investment companies manage trillions of dollars of other people's money, and they charge significant fees for their services. In building wealth, the amount paid for investment fees matters. This Article discusses the federal regulation of the fees that investment advisers charge to investments like mutual funds. Specifically, this Article analyzes the federally imposed fiduciary duty that regulates investment advisers as they extract fees from their customers. Believe it or not, even though trillions of dollars have been entrusted by hundreds of millions of Americans to investment advisers for decades, no court has found that even a single investment adviser has violated its fiduciary duty with respect to advisory fees.

America's wealthiest individuals stand on the tip of the economic pyramid. The wealthiest 400 Americans are worth a breathtaking $2.3 trillion.¹ Just look at the number of zeroes needed to illustrate that large

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number: $2,300,000,000,000. If you were to picture numerous piles of money, each containing one million dollars (i.e., $1,000,000, a paltry sum, to be sure, at least by comparison), you would have to picture 2.3 million piles! The combined wealth of America’s two richest billionaires, Bill Gates and Warren Buffett, totals $130.5 billion (i.e., $130,500,000,000).2 Whether thinking about the $2.3 trillion number or the substantially smaller $130.5 billion number, these figures represent a lot of money. But those astonishing sums of money pale when compared to how much wealth is being managed by investment companies through products such as mutual funds on behalf of millions of Americans. At the end of 2013, 98 million Americans entrusted $17.1 trillion (i.e., $17,100,000,000,000) of their wealth to U.S.-registered investment companies.3 The sheer number and size of these investment companies have grown drastically over the past few decades. At the end of 2013, they managed 22 percent of the financial assets of American households, more than tenfold the 2 percent they managed in 1980.4

Forbes-10-time.html). Of course, these types of statistics are subject to change and are always in flux.


3. Investment Company Institute, 2014 Investment Company Fact Book: A Review of Trends and Activities in the U.S. Investment Company Industry 8 (54th ed. 2014), available at http://www.icifactbook.org/pdf/2014_factbook.pdf (last visited Aug. 20, 2014). Investment companies offer various products to individual investors, including mutual funds, closed-end funds, exchange-traded funds or ETFs, and unit investment trusts or UITs. See id. at 8. At the end of 2013, $15.018 trillion was in mutual funds, $279 billion was in closed-end funds, $1.675 trillion was in ETFs, and $87 billion was in UITs. Id. at 9. This Article will mostly reference mutual funds for ease of reading, but the principles discussed apply equally to all assets managed by investment companies no matter the product, e.g., mutual or closed-end funds, ETFs, or UITs.

4. Id. at 10.
'Even though investment companies offer various products ranging from mutual funds to exchange-traded funds, this Article focuses on mutual funds for ease of discussion. A mutual fund can be defined as "a pool of assets, consisting primarily of portfolio securities, and belonging to the individual investors holding shares in the fund." These funds are not self-operated, but instead are normally "formed, sold, and managed by external organizations [called investment advisers] that are separately owned and operated." These investment advisers select the investments for and operate the day-to-day business of the funds in exchange for advisory fees that are often based on a fixed percentage of fund assets. This Article discusses the staggering amount of fees extracted from mutual funds and the fiduciary duty that investment advisers have when it comes to extracting those fees in exchange for advisory services.

To put it mildly, the relationship between a mutual fund and its investment adviser is unique, unlike the normal business relationship between buyers and sellers. The uniqueness stems from the fund’s organizational structure under which the investment adviser provides the fund with most management services, while the fund investors purchase shares in the fund and rely exclusively on the investment adviser’s services. As a practical matter, a mutual fund has no way of severing its relationship with the investment adviser, which normally creates and then operates the fund. As a result of the captive nature of this relationship that spawns conflicts of interest, "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." Without free-market forces that promote

5. See supra note 2.
8. Id.
9. Id.
10. Id.
11. Id.
12. Id. The Supreme Court has recognized that given this unique aspect of how mutual funds are structured, "[t]he relationship between investment advisers and mutual funds is fraught with potential conflicts of interest . . . ." Burks v. Lasker, 441 U.S. 471, 481 (1979) (citing Galfand v. Chestnutt Corp., 545 F.2d 807, 808 (2d Cir. 1976)).
competition and bargaining, captive funds often lack the ability to seek lower advisory fees.\(^\text{13}\)

In response to the structural conflicts of interest in the mutual fund industry, the captive nature of many mutual funds, and the massive amounts of money in this sector of the economy, Congress enacted section 36(b) of the Investment Company Act of 1940 (“ICA”) to protect mutual fund shareholders. It imposes a fiduciary duty on a mutual fund’s investment adviser with respect to its receipt of compensation.\(^\text{14}\) The governing standard that determines whether an investment adviser has breached its fiduciary duty with respect to the receipt of compensation has been well known for over three decades:

To [violate] § 36(b), . . . the adviser-manager must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm’s-length bargaining.\(^\text{15}\)

To any enterprising judge, attorney, or law student, this so-called Gartenberg standard\(^\text{16}\) seems pretty straightforward and should be easy to apply to facts to reach a legal conclusion as to when an investment adviser has breached its fiduciary duty. Tragically, that is not the case and might never be the case. Like a modern-day search for Raphus cucullatus,\(^\text{17}\) you will be hard-pressed to have a sighting of a mutual fund shareholder who wins a section 36(b) fiduciary duty case. In the forty-five years in which section 36(b) has provided federal protection for mutual fund shareholders against excessive fees by investment advisers, not a single adjudicated case reports a shareholder victory.\(^\text{18}\)


\(^\text{15}\) Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 694 F.2d 923, 928 (2d Cir. 1982); see Jones v. Harris Assoc. L.P., 559 U.S. 335, 346 (2010).

\(^\text{16}\) The term “Gartenberg standard” resulted from the name of the case that interpreted section 36(b) to create the governing legal standard.


In teaching legal reasoning and how to learn the law, I challenge my law students to clearly state the governing legal standard, explain the purpose behind the law, and provide a factual illustration of how the standard applies. As described briefly above, the first two tasks in section 36(b) litigation can be accomplished in short order with little effort. The third task does not fall readily off the tongue. Can anyone—whether investment adviser, mutual fund shareholder, attorney, or judge—look at all of the services provided by an investment adviser to a mutual fund and then determine the appropriate range of compensation for those services that indicates arm's-length bargaining? That is, can anyone confidently illustrate factually in a contested case when an investment adviser breaches its fiduciary duty with respect to the receipt of compensation under section 36(b)?

This Article contends that if one cannot illustrate when a legal standard is violated, then there is no legal standard; there is no legal protection. It is illusory. It might set a theoretical or moral obligation, but that obligation cannot be enforced. That has been the state of affairs in section 36(b) litigation for four decades.

As the opening paragraph revealed, average Americans entrust over $17.1 trillion of their savings to investment advisers, who create and operate mutual funds in exchange for fees. As you will discover in reading this Article, investment advisers charge lower fees to the wealthiest Americans than they do to average Americans. This Article contends that the wealthiest Americans can freely and fiercely bargain with investment advisers over services and fees, giving them the ability to walk away from any bad deal on low services or high fees. This bargaining power is noticeably absent from the captive retail mutual funds that are available to millions of average Americans.

The lack of arm’s-length bargaining by millions of Americans results in higher fees and has a direct impact on wealth creation. Between 2012 and 2013, Americans entrusted a staggering $2.3 trillion of additional capital to investment companies. That $2.3 trillion figure can be used to illustrate a point. In addition to representing the additional amount of money

2001)) (stating that “post-Gartenberg, no plaintiff shareholder has persuaded a court that an [investment] adviser breached its fiduciary duty by charging excessive fees.”); Jones v. Harris Assocs. L.P., 537 F.3d 728, 730 (7th Cir. 2008) (per curiam) (Posner, J., dissenting from denial of rehearing en banc) (recognizing that “[s]ubsequent litigation [after Gartenberg] in excessive fee cases has resulted almost uniformly in judgments for the defendants . . . although there have been some notable settlements wherein defendants have agreed to prospective reduction in the fee schedule.”) (quoting Cox ET AL., supra, at 1211)).

entrenched to investment companies in the past year, $2.3 trillion also represents the net worth of the 400 wealthiest Americans. These are the individuals who can freely bargain over investment services and fees. Investors in captive retail mutual funds have little bargaining power, and they pay higher fees for investor services. Even if the wealthiest Americans and average Americans get the same performance from investment advisers over time, the wealthiest Americans will see their savings grow more rapidly than what average Americans will enjoy due to the differences in advisory fees. For example, let's simply compare how higher fees impact the $2.3 trillion that we have been discussing. Please assume that (1) the 400 wealthiest Americans entrust their $2.3 trillion with an investment adviser who charges .5% of assets under management and delivers 8% per year for forty years and (2) millions of average Americans also entrust their collective $2.3 trillion to the same investment adviser who charges 1% of assets under management and delivers 8% per year for forty years. Without any additional investments, the average Americans will have suffered over $7 trillion in higher fees for the same investment results. Net fees (and without assuming taxation), the 400 wealthiest Americans' $2.3 trillion investment will balloon to over $41 trillion, while the $2.3 trillion belonging to millions of average Americans will top out at just over $34 trillion. Fees matter in a big, big way!

Section 36(b)'s fiduciary duty was intended to assuage this negative effect from the lack of spirited competition over fees for captive mutual funds. But it has failed miserably to carry out this intent. This Article exposes the illusory, unjust legal standard that implements section 36(b)'s fiduciary duty under which investment advisers operate. To carry out this task, the Article will first explain section 36(b)'s legislative text, purpose, and history. Next, the Article will showcase the judicial history of section 36(b) litigation; in the process, it will highlight a massive cavity in four decades of caselaw that has resulted in not a single, adjudicated case in which a mutual fund shareholder has prevailed. Finally, this Article will provide some thoughts on how section 36(b)'s fiduciary duty and the accompanying four decades of litigation can be viewed through the lens of a Judeo-Christian worldview.

II. LEGISLATIVE TEXT AND PURPOSE

As mentioned in the Introduction section, section 36(b) of the ICA provides federal protection for mutual fund shareholders by requiring that the fund's investment adviser meet a fiduciary duty with respect to its
receipt of compensation for the services it provides. Specifically, federal law establishes the following fiduciary duty for investment advisers:

the investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company, or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser.

A violation of this federally protected fiduciary duty can be enforced by bringing a lawsuit against the offending investment adviser by either the Securities and Exchange Commission ("SEC") or a security holder of the investment company (e.g., mutual fund shareholder). The plaintiff bears the burden to prove a breach of fiduciary duty. If a plaintiff successfully proves that an investment adviser breached its fiduciary duty, an award of damages is limited to a period of one year before the suit was brought and "to the actual damages resulting from the breach of fiduciary duty and shall in no event exceed the amount of compensation or payments received from such investment company, or the security holders thereof, by" the investment adviser.

Congress's purpose in enacting the ICA was to support "the national public interest and the interest of investors" by ensuring that investors are not "adversely affected when investment companies are organized, operated, managed, or their portfolio securities are selected, in the interest of . . . investment advisers . . . rather than in the interest of [share]holders" and "when investment companies . . . are not subjected to adequate independent scrutiny." Congress "declared that the policy and purposes of . . . [the ICA] . . . are to mitigate and, so far as is feasible, to eliminate the conditions . . . which adversely affect the national public interest and the interest of investors." Congress instructed courts to interpret the ICA to carry out these declared policies and purposes.

21. Id. (emphasis added).
22. Id.; see id. § 80a-2(a)(7) (defining "Commission" as the "Securities and Exchange Commission").
23. Id. § 80a-35(b)(1).
24. Id. § 80a-35(b)(3).
25. Id. § 80a-1(2), (5).
26. Id. § 80a-1.
27. Id.
Tellingly, section 36(b)’s legislative history tracks the textual declaration of section 36(b)’s purpose. According to the United States Senate Committee on Banking and Currency (“the Senate Committee”), “the unique structure of mutual funds has made it difficult for the courts to apply traditional fiduciary standards” when examining fees. The Senate Committee, therefore, “adopted the basic principle that, in view of the potential conflicts of interest involved in the setting of these fees, there should be effective means for the courts to act where mutual fund shareholders or the SEC believe there has been a breach of fiduciary duty.”

To legislatively implement that purpose, the Senate Committee sought a lofty goal:

[to] make it clear that, as a matter of federal law, the investment adviser . . . has a fiduciary duty with respect to mutual fund shareholders. It provides an effective method whereby the courts can determine whether there has been a breach of this duty by the adviser . . . with respect to their compensation from the fund.

This Article argues that the Senate Committee was way off in its prediction that it had drafted a clear standard that courts could interpret and apply effectively to hold investment advisers to their fiduciary duty. In over four decades of searching for a set of adjudicated facts that illustrates a violation of section 36(b)’s fiduciary duty, the law is still scratching its head. There are no such cases; there is no such set of facts. As a result, section 36(b) has not served its purpose, nor has it solved the problems for which it was enacted.

III. LEGISLATIVE HISTORY

How did section 36(b)’s federally protected fiduciary duty and cause of action arise? This section answers that question by reviewing section 36(b)’s legislative history.

28. See discussion infra Part III.
30. Id.
31. Id. (italics added to foreshadow the irony inherent in the Senate Committee’s stated goal to ensure that section 36(b)’s fiduciary duty would set a clear standard and an effective method to ensure that courts could hold investment advisers to account for breaching their fiduciary duty, because no shareholder has ever proved a violation of section 36(b)).
32. See Yeung & Freeman, supra note 18, at 493–510 (2010). In researching the legislative history behind section 36(b), I cannot overstate how influential the Yeung-
In 1935, Congress determined that hard-working Americans who entrust their savings to investment companies deserve legal protection. Acting under congressional direction, the SEC studied and filed a report on investment companies, which led to the enactment of the ICA. The ICA recognized that as assets under the management of investment companies rise, the legal protection of investors must keep pace; to that end, additional studies and reports were authorized. When legions of Americans entered periods of prosperity and growth in the 1950s, Congress recognized that mutual fund companies held significant assets of the investing public. Concerned that legal protections for ordinary investors were not keeping pace with the rapid and massive growth enjoyed by mutual fund companies, the SEC commissioned the Wharton School of Finance and Commerce at the University of Pennsylvania in 1958 to study investment companies. This resulted in the famous 1962 Wharton Report.

The Wharton Report revealed that mutual fund clients did not have the same bargaining power over fees as non-fund clients enjoyed, resulting in fund clients paying more for investment advisory services than non-fund clients. In fact, it appeared that many investment advisers charged fees to

Freeman article was in guiding my path. Although I mainly cite to the principal documents in discussing the legislative history, I give enormous credit to these authors for shining a bright light on the path that led to the congressional enactment of section 36(b). See id. at 485 n.11 (explaining that because "a thorough examination of the legislative history under section 36(b), in order to ascertain Congress's intent, [had] not been done[,]" their "article fills that void."); id. at 493 n.58 (citing Gerard T. Manges, The Investment Company Amendments Act of 1970, 26 BUS. LAW. 1311 (1971); Gerard H. Manges, The Investment Company Amendments Act of 1970—An Analysis and Appraisal After Two Years, 14 B.C. INDUS. & COM. L. REV. 387 (1973); Walter P. North, A Brief History of Federal Investment Company Legislation, 44 NOTRE DAME LAW. 677 (1969); Walter P. North, The Investment Company Amendments Act of 1970, 46 NOTRE DAME LAW. 712 (1971); Alan W. Rottenberg, Developing Limits on Compensation of Mutual Fund Advisers, 7 HARV. J. ON LEGIS. 309 (1970); Robert N. Cowen, Note, Mutual Fund Advisory Fees and the New Standard of Fiduciary Duty Interpreting the 1970 Mutual Fund Act, 56 CORNELL L. REV. 627 (1971)).

34. Id.
35. See id.
36. See id.
fund clients that were .2% of assets more than what they charged non-fund clients. In a dizzying display of stunning symmetry, it was discovered that 79.3% of funds were charged a flat fee while 79.3% of non-fund clients were charged a scaled or negotiated fee. The Wharton Report "questioned the presence of arm's length negotiation" in the mutual fund context that could lower fees, the way that fees were reduced for non-fund clients.

The SEC also conducted a detailed study of the securities industry and mutual funds. The SEC's 1966 Report on the Public Policy Implications of Investment Company Growth mostly mirrored the findings of the Wharton Report, concluding that investment advisers charged fund clients more than non-fund clients. This further indicated that fund clients did not enjoy robust negotiating power over fees with investment advisers the way that non-fund clients did. The SEC Report further revealed that shareholders of funds internally managed by advisers paid nearly twice as much in fees for services than fund shareholders in externally managed funds, again demonstrating how the lack of bargaining power artificially increases fees for investment services. The SEC also reported that because investment

"found that investment advisers often charged mutual funds higher fees than those charged the advisers' other clients and further determined that the structure of the industry, even as regulated by the ICA, had proven resistant to efforts to moderate adviser compensation." (citing Wharton Sch. of Fin. & Com., Study of Mut. Funds, H.R. Rep. No. 87-2274, at 28-30, 34, 66-67 (1962)).

40. Yeung & Freeman, supra note 18, at 494 nn.62-63; Wharton Report, supra note 39, at 484, 489. If an investment adviser had $10,000,000,000 of assets under management with $5,000,000,000 in non-fund accounts with a .3% fee and $5,000,000,000 in fund accounts with a .5% fee, non-fund clients would pay $15,000,000 in fees in the first year while fund clients would pay $25,000,000 in fees.

41. Yeung & Freeman, supra note 18, at 494 n.65; Wharton Report, supra note 39, at 480.

42. Yeung & Freeman, supra note 18, at 495; see also id. at 495 n.68 ("These findings suggest that the special structural characteristics of this industry, with an external adviser closely affiliated with the management of the mutual fund, tend to weaken the bargaining position of the fund in the establishment of advisory fee rates. Other clients have effective alternatives, and the rates charged them are more clearly influenced by the force of competition.") (citing Wharton Sch. of Fin. & Com., Study of Mut. Funds, H.R. Rep. No. 87-2274, 521 (1962)).


advisers’ fees were often based on a fixed percentage of the mutual fund’s assets—and not on the cost of actual services rendered—as those assets grow, the fixed-percentage format could result in unreasonable fees due to the fact that the adviser would realize economies of scale in managing larger portfolios. The SEC concluded that fund advisers did not compete to provide services to its funds, resulting in no “downward pressure on fee pricing.” Compounding the problem was the fact that mutual funds were similarly situated across the industry, such that a shareholder moving from one fund to another would still lack sufficient bargaining power to lower fees. If you think that fund shareholders should simply fire an investment adviser who charges high fees, the SEC concluded that was not a viable, realistic option because “[t]he adviser and its affiliates typically manage the portfolio, distribute fund shares, provide all management, and maintain control over a fund’s books and records” such that “[t]he costs and disruption that would accompany the replacement of an adviser ‘make termination of the existing advisory relationship a wholly unrealistic alternative in negotiations over advisory fees.’”

Engendering considerable controversy, the SEC proposed that because there were no enforceable constraints on advisory fees, the ICA should be amended so that all investment advisory fees would be subject to a standard of reasonableness. Both the House and the Senate took up bills and held hearings on the SEC’s proposed fiduciary standard.

The mutual fund industry vehemently denied and opposed many of the findings, conclusions, and recommendations of the Wharton Report and SEC Report. The industry countered that investors were sufficiently protected through competition and existing law.

As the federal legislation moved forward, it became apparent that some type of fiduciary duty was going to be enacted that would govern investment advisers. As legislation was promoted and debated, the Senate

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51. Yeung & Freeman, supra note 18, at 500; S. 1659 § 8(d); H.R. 9510 § 8(d).
52. Yeung & Freeman, supra note 18, at 501.
53. Id. at 502.
Committee took the lead on conducting hearings to amend the ICA.\textsuperscript{54} The Senate's bill to amend the ICA sought to "update our nation's securities laws so that they will be better suited for an ever-expanding investment company industry."\textsuperscript{55} In 1968, a Senate bill containing a reasonableness standard was reported out of the Senate Committee, which specifically highlighted how the unique structure of mutual funds created inherent conflicts of interest that prohibited effective competition on price normally accomplished through arm's-length bargaining.\textsuperscript{56} The Senate Committee exhorted that this new fiduciary standard of reasonableness would "provide a meaningful mechanism through which the management fee which may be unreasonable can be effectively challenged" in federal court.\textsuperscript{57} Meaningful, substantive debate took place over the pros and cons of the proposed fiduciary duty, but the 1968 legislation failed to garner enough support.

While the earlier Senate bill would have restricted investment advisers to charging only "reasonable" fees, this standard was eventually dropped in favor of placing "a specific 'fiduciary duty' [on an investment adviser] in respect to management fee compensation."\textsuperscript{58} When a bill emerged from the Senate Committee, a newly created section 36(b) regulated investment advisers by requiring them to comply with a "fiduciary duty with respect to compensation for services or other payments paid by the fund or its shareholders to the adviser."\textsuperscript{59}

In reaching a consensus on the newly created fiduciary duty standard, the Senate Committee recognized "that on the whole the investment company industry reflects diligent management by competent persons" and was "impressed by the value of the services that the investment company industry has provided and can provide in the future to the many investors who wish to put their savings in broadly diversified and professionally managed securities portfolios."\textsuperscript{60} Recognizing that "adequate compensation and incentives" would attract people "of ability and integrity" to the mutual fund industry, the Senate Committee nonetheless concluded that "investors

\textsuperscript{55} Id. at 2, 1970 U.S.C.C.A.N. at 4898.
\textsuperscript{56} Yeung & Freeman, supra note 18, at 504; S. Rep. No. 90-1351, at 5 (1968).
\textsuperscript{57} Yeung & Freeman, supra note 18, at 505 (quoting S. Rep. No. 90-1351, at 5). Please continue reading so that you, too, may conclude that these legislators were way off in their predictive abilities!
\textsuperscript{59} Id. at 6, 1970 U.S.C.C.A.N., at 4902; Yeung & Freeman, supra note 18, at 506.
should share equitably . . . in the economies available as a result of the growth and general acceptance of mutual funds."

The Senate Committee then encapsulated the unique challenges confronting mutual fund shareholders and the potential for abuse in the fees charged for mutual fund services—the captive nature of advisers to funds, the inherent conflicts of interest in how mutual funds are structured, and the lack of normal market forces that allow arm's-length bargaining. The Senate Committee succinctly explained why the structure of investment companies caused concern:

Mutual funds, with rare exception, are not operated by their own employees. Most funds are formed, sold, and managed by external organizations that are separately owned and operated. These separate organizations are usually called investment advisers. The advisers select the funds' investments and operate their businesses. For these services they receive . . . advisory fees. These fees are usually calculated a[s] a percentage of the funds' net assets . . . .

Because of the unique structure of this industry the relationship between mutual funds and their investment adviser is not the same as that usually existing between buyers and sellers or in conventional corporate relationships. 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.

The Senate Committee explained that, historically, investment advisory fees charged to mutual fund shareholders could only be challenged under state law.

62. Id.
63. S. Rep. No. 91–184, at 5, 1970 U.S.C.C.A.N., at 4901. The Supreme Court has recognized that in enacting section 36(b) to impose a fiduciary duty on investment advisers, "Congress was concerned about the potential for abuse inherent in the structure of investment companies." Burks v. Lasker, 441 U.S. 471, 480 (1979). The Supreme Court has further recognized that given this unique aspect of how mutual funds are structured, "[t]he relationship between investment advisers and mutual funds is fraught with potential conflicts of interest." Id. at 481 (citing Galfand v. Chestnut Corp., 545 F.2d 807, 808 (2d Cir. 1976)).
law "corporate waste" standards, which required fees to "shock the conscience."\(^{64}\) Recognizing that this rule may be proper "when the protections of arm's-length bargaining are present," it is "unduly restrictive" when applied to "the mutual fund industry where . . . marketplace forces are not likely to operate as effectively."\(^{65}\)

The Senate Committee clarified that adding a federally protected fiduciary duty did not imply that investment advisers were not entitled to make a profit or that advisers would have their rates regulated like public utilities.\(^{66}\) The Senate Committee also cautioned that adding a fiduciary duty did not mean "that the present industry level of management fees or that the fee of any particular adviser is too high."\(^{67}\) But the Senate Committee did indicate that as the mutual fund industry enjoys dramatic growth, the economies of scale enjoyed by advisers should be shared with investors by reducing fees as funds grow.\(^{68}\) Tellingly, the Senate Committee declared that "the best industry practice will provide a guide" as to how economies of scale should be shared with investors.\(^{69}\) The Senate Committee declared that although courts would not be authorized to substitute their business judgment on fees over boards of directors, the creation of a fiduciary duty on fees was meant to "provide a mechanism for court enforcement of this duty."\(^{70}\)


\(^{65}\) Id. The Supreme Court has recognized that the SEC Report "concluded that lawsuits by security holders challenging the reasonableness of adviser fees had been largely ineffective due to the standards employed by courts to judge the fees." Daily Income Fund, Inc. v. Fox, 464 U.S. 523, 537 (1984) (citing SEC Report, H.R. REP. NO. 89–2337, at 132-43). The Court illustrated the difficulty that shareholders had faced in excessive fee cases before section 36(b) was enacted:

In the three cases cited by the SEC, the courts had evaluated the adviser contracts according to common law standards of corporate waste, under which an unreasonable or unfair fee might be approved unless the court deemed it "unconscionable" or "shocking." Similarly, security holders challenging adviser fees under the [ICA] itself had been required to prove gross abuse of trust. Id. at 540 n.12 (citing SEC Report, H.R. REP. NO. 89–2337, at 142; Acampora v. Birkland, 220 F. Supp. 527, 548-49 (D. Colo. 1963); Saxe v. Brady, 184 A.2d 602, 610 (Del. Ch. 1962); Meiselman v. Eberstadt, 170 A.2d 720, 723 (Del. Ch. 1961); Brown v. Bullock, 194 F. Supp. 207 (S.D.N.Y. 1961), aff'd, 294 F.2d 415 (2d Cir. 1961); Mutual Fund Legislation of 1967: Hearings on S. 1659 Before the Senate Comm. on Banking & Currency, 90th Cong., 1st Sess., 117-18 (1967)).


\(^{67}\) Id.

\(^{68}\) Id.

\(^{69}\) Id.

\(^{70}\) Id. (emphasis added).
The House Committee on Interstate and Foreign Commerce mostly followed the Senate Committee's lead. Finding that "arm's length bargaining was not particularly effective in the fund industry," the House Committee agreed that "a change in the standard for testing management fees is appropriate and needed."\(^\text{71}\)

The final bill passed the House and the Senate, and President Richard M. Nixon signed the bill into law on December 14, 1970.\(^\text{72}\)

Identifying an industry that lacks normal market constraints like competition and arm's-length bargaining, Congress enacted a fiduciary duty that courts could readily enforce to ensure that mutual fund investors were not harmed by excessive fees. This Article asks whether Congress successfully enacted a standard that can be consistently interpreted and applied to ensure that society knows what fees are unlawful. Although the legal standard that implements section 36(b)'s fiduciary duty is crystal clear in its recitation, the ability to forecast unlawful behavior under the standard is non-existent. To that end, there is no just and enforceable standard. The following section highlights that no fund shareholder has proved in court that an investment adviser breached its section 36(b) fiduciary duty.

IV. JUDICIAL HISTORY

Mutual fund shareholders have endured a long quest to prove that an investment adviser has extracted unlawful fees from them. Like Frodo from the Lord of the Rings, it seems like the shareholders' quest is unending without the possibility of victory.\(^\text{73}\) Like Frodo's burden of the ring, fund shareholders have borne the heavy burden of fees without a judicial victory.

A. Pro-corporation State Law

Before section 36(b)'s federally protected fiduciary duty and cause of action were created in 1970, mutual fund shareholders were stuck in state courts when trying to plead and prove that investment advisers charged excessive fees.\(^\text{74}\) Two pro-corporation theories—the business judgment rule and shareholder ratification—often stood in the way of shareholder success.\(^\text{75}\) The business judgment rule mostly insulated corporate boards

72. Id. at 510; 116 Cong. Rec. 41, 623 (1970).
74. Yeung & Freeman, supra note 18, at 486.
75. Id. at 486-87.
from judicial review of their fee determinations, while shareholder ratification of board decisions created a heavy burden to prove corporate waste.\textsuperscript{76} To meet this latter burden, a fund shareholder was required to prove that "what the corporation has received is so inadequate in value that no person of ordinary, sound business judgment would deem it worth what the corporation has paid"; the failure to meet this standard resulted in the dismissal of the shareholder's complaint.\textsuperscript{77} Indeed, the Supreme Court of the United States succinctly described the predicament in which investors found themselves when trying to prove state-law claims of excessive fees:

the [SEC] concluded that the [ICA]'s provisions for independent directors and approval of adviser contracts had actually frustrated effective challenges to adviser fees. In particular, the [SEC] noted that in the three fully litigated cases in which security holders had attacked such fees under state law, the courts had relied on the approval of adviser contracts by security holders or unaffiliated directors to uphold the fees.\textsuperscript{78}

With the creation of section 36(b)'s fiduciary duty and a private cause of action, shareholder litigation against investment advisers over excessive fees mostly abandoned state courts in favor of federal courts. Given the newly created, federally protected fiduciary duty, a new legal standard was needed to analyze excessive-fee claims.

B. Federal Courts' Interpretation of Section 36(b)'s Fiduciary Duty

Twelve years after Congress enacted section 36(b), in 1982, the United States Court of Appeals for the Second Circuit issued its seminal decision interpreting section 36(b) in \textit{Gartenberg v. Merrill Lynch Asset Management, Inc.}\textsuperscript{79} For the past three decades, this seminal case has guided courts' analyses of section 36(b) cases by providing the analytical framework in the form of the \textit{Gartenberg} standard and the \textit{Gartenberg

\textsuperscript{76} Id.

\textsuperscript{77} Id. at 487-88 (relying on a trio of state-law cases that showcased how difficult it was to prove corporate waste in the shareholder context under state law) (citing \textit{Saxe v. Brady}, 184 A.2d 602, 604, 610, 613 (Del. Ch. 1962); \textit{Acampora v. Birkland}, 220 F. Supp. 527, 548-49 (D. Colo. 1963); \textit{Meiselman v. Eberstadt}, 170 A.2d 720, 723 (Del. Ch. 1961)).


\textsuperscript{79} 694 F.2d 923 (2d Cir. 1982).
factors.\textsuperscript{80} The Gartenberg standard simply states that to prove a violation of section 36(b), a shareholder must show that "the adviser-manager [charged] 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."\textsuperscript{81} The Gartenberg court developed factors to apply to the facts of a case to determine whether the standard of liability had been met. These factors became known as the Gartenberg factors, and here is a list of them:

(a) the nature and quality of services provided to fund shareholders; (b) the profitability of the fund to the adviser-manager; (c) fall-out benefits; (d) economies of scale; (e) comparative fee structures; and (f) the independence and conscientiousness of the trustees.\textsuperscript{82}

\textsuperscript{80} It might be interesting to note that there were two named plaintiffs in the Gartenberg case—Irving L. Gartenberg and Simone C. Andre. \textit{Id.} at 923. The first named plaintiff—Gartenberg—has enjoyed the fortune (or misfortune) of having a seminal decision, a legal standard, and legal factors named after him. If the named plaintiffs had been reversed on the caption, however, then courts would have referenced and applied the Andre standard and the Andre factors versus the Gartenberg standard and the Gartenberg factors. Chance led to the Gartenberg versus Andre standard, which reminds me of a funny story told by Tommy John, a former professional baseball player. Tommy John had a ground-breaking, career-saving operation called ulnar collateral ligament reconstruction to his pitching arm; that revolutionary surgery is now famously referred to as "Tommy John Surgery." See Dan Patrick, \textit{Just My Type: Tommy John, Sports Illustrated}, May 26, 2014; Matt McCarthy, \textit{Tommy John Surgery, Sports Illustrated}, Sept. 8, 2014 (explaining that "Tommy John surgery" is "named after the Dodgers lefty who underwent the first UCL reconstruction, in 1974."). Every pitcher since Tommy John who has undergone the same operation is now referred to as having had Tommy John Surgery. See McCarthy, supra (stating that, on average, more than sixteen major league pitchers underwent Tommy John Surgery between 2000 and 2011, thirty-six had it in 2012, and twenty-six pitchers currently in the major leagues have had the surgery). Tommy John has explained that he has had no bad feelings in having had the surgery named after him and not after Brent Strom, the second person to have had the surgery. See Patrick, supra. Tommy John also has told a funny story about how Coach Tommy LaSorda of the Los Angeles Dodgers was thankful that Tommy John was the first to have the surgery: "Thank God it wasn't [infelder] Billy Grabarkewitz who had it first. Who would want to say that?" \textit{Id}. So instead of regaling about the Billy Grabarkewitz surgery, we reference the Tommy John surgery, and in lieu of the Andre standard, courts have used the Gartenberg standard.

\textsuperscript{81} \textit{Gartenberg}, 694 F.2d at 928 (emphasis added).

\textsuperscript{82} \textit{Krinsk v. Fund Asset Mgmt., Inc.}, 875 F.2d 404, 409 (2d Cir. 1989) (citing \textit{Gartenberg}, 694 F.2d at 929-30); see \textit{Gallus v. Ameriprise Fin., Inc.}, 561 F.3d 816, 821 (8th Cir. 2009) (citing \textit{Gartenberg}, 694 F.2d at 928-31).
You can think of the factors as analytical tools that unlock the actual legal standard. When the factors are used to analyze the facts of actual cases, the decision on whether the underlying standard has been violated should become clearer. A violation of the legal standard likewise results in a legal conclusion that an investment adviser breached its section 36(b) fiduciary duty with respect to the receipt of compensation.

Thirty-three years after Gartenberg, every federal court that has applied the Gartenberg standard and the Gartenberg factors has concluded that fund shareholders failed to prove that an investment adviser breached its section 36(b) fiduciary duty with respect to the receipt of compensation. Apparently, investment advisers operating under a federally protected fiduciary duty with respect to the receipt of compensation in managing trillions of dollars belonging to hundreds of millions of Americans have been squeaky clean and without fault for decades. In the next section, this Article discusses the pivotal cases in section 36(b) litigation.

1. Second Circuit Creates Seminal Gartenberg Standard and Factors

There is no better place to start than with the facts of the seminal Gartenberg case. In Gartenberg, two fund shareholders of the Merrill Lynch Ready Assets Trust sued the investment adviser who managed the mutual fund for violating its section 36(b) fiduciary duty in charging excessive fees for giving investment advice and operating the fund. The mutual fund at issue was a common money market fund, in which the manager invested shareholders' funds in short-term money market securities with the goal to provide income, preserve capital, and maintain liquidity. In essence, this type of fund acts more like a bank account than a traditional mutual fund that invests in marketable securities. In just four years with investors flocking to the fund, the fund grew from $288 million to over $19 billion. The investment adviser provided all of the necessary services—office space, staff, portfolio management, recordkeeping, reporting, correspondence, etc.—to the fund and its shareholders. The fund performed "reasonably well," producing "slightly above the average"

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83. Gartenberg, 694 F.2d at 925-27, 930-34, n.4. This Article recounts the facts as described by the Second Circuit. For a more detailed recitation of the facts, please review the trial court’s decision. See Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 528 F. Supp. 1038, 1040-44 (S.D.N.Y. 1981), aff’d, 694 F.2d 923 (2d Cir. 1982).
84. Gartenberg, 694 F.2d at 925.
85. Id.
86. Id.
87. Id. at 926.
88. Id.
returns when compared with similar funds. For these services, the adviser charged a fee based on the fund’s net assets. When fund assets remained under $500 million, the fund paid a .5% fee, and as fund assets grew, the fixed percentage gradually decreased, to the point that when fund assets exceeded $2.5 billion, the fee was .275%. This staggered-fee schedule resulted in an effective rate of .288%.

The district court held a bench trial on the section 36(b) claims, after which it dismissed the fund shareholders’ suit for failing to prove that the fees were so disproportionately large to constitute a breach of the fiduciary duty. The district court concluded that the adviser’s services were extensive, valuable, and unavailable to other funds.

On appeal, the fund shareholders’ chief argument was that the fee percentage that may have been lawful when the fund was new became excessive when the fund rapidly grew into a multi-billion dollar fund. Essentially, the fund shareholders argued that unless the fund’s expenses actually increased at the same rate as the assets under management—an almost-impossible proposition given the economies of scale—then the fee percentage should drop significantly as assets rise. This theme is commonly known as forcing the investment adviser to share the economies of scale with the fund shareholders.

Acknowledging the lack of competition among investment advisers, the Second Circuit promptly rejected the district court’s assertion that a key factor is to compare industry fees:

We disagree with the district court’s suggestions that the principal factor to be considered in evaluating a fee’s fairness is the price charged by other similar advisers to funds managed by them, that the “price charged by advisers to those funds establishes the free and open market level for fiduciary compensation,” that the “market price . . . serves as a standard to test the fairness of the investment advisory fee,” and that a fee is fair if it “is in harmony with the broad and prevailing market choice available to the investor.” Competition between money market funds for shareholder business does not support an

89. Id.
90. Id.
91. Id.
92. Id.
93. Id. at 925.
94. Id. at 927.
95. Id. at 928.
inference that competition must therefore also exist between adviser-managers for fund business. The former may be vigorous even though the latter is virtually non-existent. Each is governed by different forces. Reliance on prevailing industry advisory fees will not satisfy § 36(b).96

The court noted that fees extracted by advisers from similar funds could be taken into account. The relevance of such evidentiary comparisons probably does not tend to support higher fees, however, but rather tends to show that as one adviser reduces its fees as its fund grows, this reduction in fees should probably serve as a best practice in the industry.97 Notwithstanding such a utopian vision, most funds exist within "an unseverable relationship" with the adviser, a common fact that "tends to weaken the weight to be given to rates charged by advisers of other similar funds."98 Because it is not easy for a fund to change advisers, a hallmark of competition is lacking, which leads to the unfortunate conclusion that "investment advisers seldom, if ever, compete with each other for advisory contracts with mutual funds."99 The Second Circuit also recognized that shareholders tend not to even seek competition between advisers based on fees, particularly because the actual fee charged to each shareholder, as opposed to the fund, might seem relatively insignificant.100

Given "the potentially incestuous relationships between many advisers and their funds," the court recognized that Congress determined that other factors might be more important when analyzing whether an investment adviser charged an excessive fee to constitute a breach of its fiduciary duty.101 The court recognized that relevant factors include "the adviser[]'s cost in providing the service, the nature and quality of the service, the extent to which the adviser[] realizes economies of scale as the fund grows larger, and the volume of orders which must be processed by the manager."102 Rounding out the list, the court also identified as relevant factors "the expertise of the independent trustees of a fund, whether they are fully informed about all facts bearing on the adviser[]'s service and fee, and the extent of care and conscientiousness with which they perform their

96. Id. at 929 (emphasis added) (quoting Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 528 F. Supp. 1038, 1049, 1067-68 (S.D.N.Y. 1981), aff'd, 694 F.2d 923 (2d Cir. 1982)).
100. Id.
101. Id. at 929-30.
102. Id. at 930.
duties." The court cautioned that "even if the trustees of a fund endeavored to act in a responsible fashion, an adviser['s] fee could [nevertheless] be so disproportionately large as to amount to a breach of fiduciary duty in violation of § 36(b)." After defining the governing legal standard and laying out the analytical factors, the court applied the law to the facts of the case to conclude—as all courts have done for decades—that fund shareholders had failed to meet their burden to prove that the investment adviser charged an excessive fee in breach of its section 36(b) fiduciary duty. To properly analyze an excessive-fee case, the law requires a comparison between the services rendered and the fees charged. Following that approach, the Second Circuit recognized that on the services side of the analytical ledger, the investment adviser had provided "the highest quality" of services and "better-than-average return[s]." The court then moved on to a consideration of the fees charged, instantly recognizing that the fees dramatically increased from $1.5 million to nearly $40 million in four years as the fund’s size exploded "from $428 million to over $19 billion." Even though the fees increased dramatically, the court realized that the services provided also increased due to a greater number of customers, increased daily transactions, and a tripling of orders that needed to be processed. In response, the court explained, the adviser’s "rate was graduated downward to reflect the economies [of scale] that might be realized from the increase in the value of the [fund’s] net assets."

One sticking point that the court considered, however, was the fund shareholders’ claim that the investment adviser had failed to consider fall-out and float benefits. The adviser had, through a subsidiary, "gained large ‘fall-out’ financial benefits annually in the form of commissions on non-Fund securities business generated by Fund customers and interest income on funds (known as the ‘float’) held by the [subsidiary] from the date when a redemption check is issued by the Fund to its customer until the date it clears." Fund shareholders contended that the adviser’s failure

103. Id.
104. Id.
105. Id.
106. Id.
107. Id.
108. Id. at 930-32.
109. Id. at 931.
110. Id. at 932.
111. Id.
to offer a "very substantial offset" for these benefits against the fees charged breached its section 36(b) fiduciary duty.112 Notwithstanding its recognition that fall-out benefits are a relevant factor and that this argument was a "serious problem," the court held that fund shareholders failed to prove that these fall-out "benefits were so substantial that they rendered the [adviser]'s fee so disproportionately large."113

Somewhat ironically, in its penultimate paragraph, the Second Circuit seemingly signaled that the fund shareholders actually could have prevailed had they provided more probative evidence on either services or fees:

Our affirmance is not a holding that the fee[s are] fair and reasonable. We merely conclude that on this record [shareholders] failed to prove . . . a breach of fiduciary duty. Whether a violation of § 36(b) might be established through more probative evidence of (1) the . . . processing costs, (2) the offsetting commission benefits realized . . . from non-Fund securities business generated by Fund accounts, and (3) the "float" interest income gained . . . from [the] method of handling payment on Fund redemptions, must therefore remain a matter of speculation.114

Although the court held that the investment adviser had not breached its fiduciary duty, it is interesting to note that the court nevertheless advised the fund's independent trustees to study the fees and services, as outlined in the opinion.115

By and large, the Gartenberg standard and factors have been applied by all federal courts for decades without a single shareholder winning a case.116 Nearly three decades later, however, the Seventh and Eighth Circuits entered the fray in decidedly different ways.

2. Seventh Circuit Cuts a Free-Market Path with Minimal Judicial Review

In 2008, the Seventh Circuit issued a decision in Jones v. Harris Associates L.P.,117 which took a dramatically different analytical path than

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112. Id.
113. Id.
114. Id. at 933.
115. Id.
116. See infra notes 294-96.
117. 527 F.3d 627 (7th Cir. 2008).
had the Second Circuit in *Gartenberg*.¹¹⁸ In *Jones*, fund shareholders brought a section 36(b) claim against an investment adviser that charged its fund “1% (per year) of the first $2 billion of the fund’s assets, 0.9% of the next $1 billion, 0.8% of the next $2 billion, and 0.75% of anything over $5 billion.”¹¹⁹ As the fund grew, so did the investment adviser’s fees. Concluding that the investment adviser had not violated its fiduciary duty, the district court granted summary judgment and dismissed the case.¹²¹

Arguing on appeal that the district court erroneously concluded that the advisory fees were not excessive, fund shareholders focused on the lack of competition to set fees and the preferential treatment on fees that investment advisers gave to institutional, non-fund clients over fund clients.¹²² Fund shareholders insisted that fund “fees are set incestuously rather than by competition,” because investment advisers create the funds and the funds rarely change advisers.¹²³ Fund shareholders also stressed that while the captive funds were being charged the rates laid out above, the investment adviser’s “institutional clients (such as pension funds)” paid considerably less in fees; for example, one such client was charged only .75% of the first $15 million and .35% of amounts over $500 million, with intermediate breakpoints.¹²⁴ Fund shareholders boldly argued “that a


¹¹⁹. *Jones*, 527 F.3d at 631.

¹²⁰. Id. at 629.

¹²¹. Id.

¹²². Id. at 631.

¹²³. Id.

¹²⁴. Id. Just doing a little back-of-the-envelope calculation, which the Seventh Circuit apparently deemed entirely irrelevant, one can see that fund shareholders pay drastically higher fees for advisory services than do institutional clients for the same amount of invested capital. Fund shareholders pay a fee totaling 1% of the first $2 billion of fund assets, while institutional clients pay only .75% of the first $15 million and .35% of amounts over $500 million. If the investment adviser advised a $2 billion captive, retail mutual fund and a $2 billion free-market institutional account, the adviser would extract an annual fee from the fund of $20 million, while it would charge its institutional client a much smaller fee of $7,060,000 for managing the same amount of money. Use your imagination to determine how those fees would pile up year after year and decade after decade. Fees matter, and competition and hard bargaining set the fees.
fiduciary may charge its controlled clients no more than its independent clients.”

Setting a tone that fund shareholders have little federal protection in trying to prove that their investment adviser charged excessive fees, the Seventh Circuit quickly dispensed with the Gartenberg standard “because it relies too little on markets.” Without much effort to even cite to authority, the court proclaimed the virtues of competition that set advisory fees in the mutual fund industry in ways that comply with section 36(b)’s fiduciary duty. Cautioning that a federally recognized “fiduciary duty differs from rate regulation,” the Seventh Circuit announced a radically different test than the Second Circuit’s Gartenberg standard: “[a] fiduciary must make full disclosure and play no tricks but is not subject to a cap on compensation.”

Attempting to extract courts from determining whether fees are excessive, the court explained that a fund’s “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.” Building upon its flurry of free-market principles that work best without judicial oversight, the court declared that even though “[c]ompetitive processes are imperfect,” they “remain superior to a ‘just price’ system administered by the judiciary,” because no matter how “weak competition may be at weeding out errors, the judicial process is worse.” To complete its point by setting up and then attacking strawmen, the court insisted that “judicial price-setting does not accompany fiduciary duties” and that “section 36(b) does not create a rate-regulation mechanism.”

Once the court interpreted section 36(b)’s fiduciary duty by creating a relaxed standard with little judicial oversight of the fees that investment advisers charge to fund shareholders, the court opined that the mutual fund industry actually overflows with competition such that judicial oversight would cause more harm than good. Finally, the court explained why it

125. Id.
126. Id. at 632.
127. Id. at 631-35.
128. Id. at 632.
129. Id.
130. Id. at 632-33.
131. Id. at 633.
132. Id. at 633-35. Regardless of Congress’s intent in enacting a federally protected right and cause of action to protect fund shareholders from investment advisers who breach their fiduciary duties with respect to fees, the court prophesied “that regulating advisory fees through litigation is unlikely to do more good than harm.” Id. at 634 (citing John C. Coates
sanctioned the investment adviser's charging dramatically reduced fees to institutional clients than it charged fund clients:

[The adviser] charges a lower percentage of assets to other clients, but this does not imply that it must be charging too much to the [mutual] funds. 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. That 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.

Federal securities laws [like the ICA] work largely by requiring disclosure and then allowing price to be set by competition in which investors make their own choices. [Fund shareholders] do not contend that [the investment's adviser] pulled the wool over the eyes of the disinterested trustees or otherwise hindered their ability to negotiate a favorable price for advisory services. The fees are not hidden from investors—and the . . . funds' net return has attracted new investment rather than driving investors away. As § 36(b) does not make the federal judiciary a rate regulator, after the fashion of the Federal Energy Regulatory Commission, the judgment of the district court is affirmed. 133

And that was that, or so it seemed. The Seventh Circuit's newly minted free-market standard for interpreting section 36(b)'s fiduciary duty would lose its luster in short order.

3. Dissenting Opinion from the Seventh Circuit's New Path

The losing shareholders petitioned for rehearing and for rehearing en banc, which the court denied. 134 Judge Richard A. Posner, an equally ambitious supporter of a law-and-economics approach to judging as Judge

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133. Id. at 634-35.
Easterbrook,\textsuperscript{135} diverged from free-market orthodoxy in how he would have decided this case. Judge Posner issued a dissenting opinion from the court’s denial of the petition for rehearing en banc.\textsuperscript{136} In it, he takes his court to task for unnecessarily creating a circuit split on a critical issue to the mutual fund industry by being the lone objector to the \textit{Gartenberg} standard.\textsuperscript{137} Judge Posner facetiously questioned the necessity to relax the legal standard that protects fund shareholders under section 36(b):

It’s not as if \textit{Gartenberg} has proved to be too hard on fund advisers…. [L]itigation in excessive fee cases has resulted almost uniformly in judgments for the defendants…. although there have been some notable settlements wherein defendants have agreed to prospective reduction in the fee schedule.\textsuperscript{138}

Judge Posner disagreed with Judge Easterbrook’s reliance on his own “economic analysis,” deeming it “ripe for reexamination.”\textsuperscript{139} Recognizing


\textsuperscript{136} \textit{Jones}, 537 F.3d at 729-33 (four judges joined in dissent).


\textsuperscript{139} \textit{Id.} Such examination, as it were, might sadly reveal that many retail investors simply do not understand or appreciate how high fees derail their investment plans: “Most workers, despite best efforts by federal regulators and others, seemingly don’t know or care how much they are paying in fees for their 401(k) or similar retirement plan. But they and you should. That’s because paying high fees for your 401(k) likely reduces your overall investment returns, and ultimately the overall size of your nest egg.” Robert Powell, \textit{9 Things You Need to Know About 401(k) Fees}, WALL ST. J. (July 8, 2014), http://www.marketwatch.com/story/9-things-you-need-to-know-about-401k-fees-2014-07-08. Laurie Rowley, the co-founder of
rampant abuse in the financial services industry, which includes the mutual fund industry, Judge Posner disagreed with the court's blind reliance on competition to protect fund shareholders, declaring that "[c]ompetition in product and capital markets can't be counted on to solve the problem" of excessive compensation. 140

Cutting to the chase, Judge Posner wrote, "A particular concern in this case is the adviser's charging its captive funds more than twice what it charges independent funds." 141 Judge Posner dismissed the court's justification of this disparity in fees, asserting that the court's "suggestions are offered purely as speculation, rather than anything having an evidentiary or empirical basis." 142 Declaring that fund shareholders "are indeed captive" of the investment adviser, Judge Posner took direct aim at the court's assertion that competition would cure all ills regardless of any notion that the funds are captive:

[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. 143

Judge Posner also criticized the court's contention that competition among funds tamps down fees by explaining that "[t]he governance structure that enables mutual fund advisers to charge exorbitant fees is industry-wide, so the [court]'s comparability approach would if widely followed allow those fees to become the industry's floor." 144 Judge Posner maintained that courts must compare fees that an investment adviser "charges independent funds with the much higher fees that it charges the funds it controls." 145 Judge Posner complained that the court rejected the appropriate, "alternative

the National Association of Retirement Plan Participants, explained, "Millions of working Americans have no idea how much they are paying [, even though] understanding how much you are paying in fees is a critical step to financial security." Id.

140. Jones, 537 F.3d at 730-31.
141. Id. at 731.
142. Id.
143. 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) (alteration in original)).
144. Id. at 732.
145. Id.
comparison . . . on the basis of airy speculation.” 146 The United States Court of Appeals for the Eighth Circuit soon rejected the Seventh Circuit’s approach, mostly lining up behind Gartenberg and Judge Posner’s decision.

4. Shareholders Gain Rare Victory in the Eighth Circuit

Following the divided Seventh Circuit’s rejection of the Gartenberg standard, the Eighth Circuit took up the issue of the appropriate legal standard to enforce section 36(b)’s fiduciary duty. In Gallus v. Ameriprise Financial, Inc., 147 fund shareholders sued their investment adviser for breach of fiduciary duty, claiming “(1) the fee negotiation was inherently flawed because it was based not on [the adviser]’s costs and profits but on external factors—namely the fee agreements of similar mutual funds in the market; (2) [the adviser] provided comparable advisory services to institutional, non-fiduciary clients at substantially lower fees than it charged the [fund shareholders], to whom it owed a fiduciary duty; and (3) [the adviser] misled the Board about its arrangements with non-fiduciary clients to prevent the Board from questioning the higher fees demanded by [the adviser].” 148 One glaring fact was that the fund shareholders paid an advisory fee that was nearly twice as high as the fee paid by institutional clients. 149 An expert testified “that the advisory service provided to the mutual funds was similar, if not identical, to the service [the adviser] provided to its institutional clients.” 150 Testimony for the adviser explained that the difference in fees was the result of the fund’s requiring additional services. 151 A seeming smoking gun piece of evidence was produced in the form of an internal e-mail message showing that the adviser knew about the disparity in fees charged to institutional clients versus fund clients. 152 The e-mail message stated that this fee-disparity issue “could come up in a Board meeting” and that “we should have a reply, though it may or may not be convincing.” 153

146. Id. Finally, Judge Posner recognized that although the court had created the wrong standard in rejecting the Gartenberg standard, “[t]he outcome of this case may be correct.” Id.
147. 561 F.3d 816 (8th Cir. 2009).
148. Id. at 818.
149. Id. at 819.
150. Id.
151. Id.
152. Id.
153. Id. (quoting Jt. App. at 616).
Unlike the Seventh Circuit, the Eighth Circuit recognized that the inherent structure of mutual funds interferes with normal market conditions that promote competition and drive down costs.\textsuperscript{154} The court acknowledged the captive nature of most mutual funds, explaining that "although mutual funds are technically owned by the individual shareholders who invest in the funds, most mutual funds are created, organized, and managed by external investment advisers—an arrangement that gives the adviser a significant amount of control over the fund it serves."\textsuperscript{155} Unwilling to follow the Seventh Circuit's lead in blindly believing that free-market competition ensures that investment advisers will not breach their federally mandated fiduciary duty, the Eighth Circuit at least considered the other side of the debate:

Experts have extensively debated the extent to which these industry characteristics interfere with robust competition and drive up fees. Studies have concluded that inherent conflicts of interest and a lack of meaningful competition between mutual funds have led to systematic overpricing of investment advice.\textsuperscript{156}

The Eighth Circuit fully understood and appreciated the shareholders' central argument:

[A]rm's-length bargaining does not occur between an adviser and a mutual fund because the fund cannot sever its relationship with the adviser. Critics claim that because this dynamic pervades the mutual fund industry, there is little competitive pressure to lower fees. This phenomenon may be exacerbated by the fact that the typical fee structure—which is established as a percentage of net asset value—will allow an adviser's compensation to skyrocket if the fee is not adjusted downward as a fund grows larger.\textsuperscript{157}

\textsuperscript{154} Id. at 820.

\textsuperscript{155} Id. One member of two mutual fund boards of directors has explained, "And if you are not independent of the management company, the notion that you can act effectively in an arm's-length bargaining capacity, vis-a-vis the management company, is silly." Ryan Bollman & Mark Andreu, Note, Jones v. Harris Associates L.P.: The Search for Investor Protection Continues, 65 U. MIAMI L. REV. 717, 724 & n.50 (quoting Kenneth E. Scott, What Role Is There for Independent Directors of Mutual Funds?, 2 VILL. J.L. & INV. MGMT. 1, 4 (2000)).

\textsuperscript{156} Gallus, 561 F.3d at 820.

\textsuperscript{157} Id. at 820-21. Writing for the Wall Street Journal recently, Chuck Jaffe eulogized Geoff Bobroff, a man with over four decades of experience in the mutual fund industry in such positions as trial attorney with the SEC in which he brought enforcement actions against
The Eighth Circuit then analyzed the Gartenberg standard and the Gartenberg factors to determine whether this longstanding analytical framework was consistent with section 36(b)'s text and purpose. The court noted that many courts had approved and applied the Gartenberg framework, while only a divided Seventh Circuit in Jones had eschewed it. The Eighth Circuit confirmed that the Second Circuit’s opinion in Gartenberg provides “a useful framework for resolving claims of excessive fees, notwithstanding the substantial changes in the mutual fund industry that have occurred in the intervening” time since Gartenberg was decided in 1982.

Importantly, the Eighth Circuit recognized what I am arguing in this Article—law is worthless without facts and facts are worthless without law. Specifically, the court explained, “Fund advisers do not have a fiduciary duty in merely an abstract sense.” Although the court adopted the Gartenberg standard, it cautioned that the standard must be applied appropriately:

But the [Gartenberg] standard . . . should not be construed to create a safe harbor of exorbitance, for under such a view an adviser’s fiduciary duty would be diluted to a simple and easily satisfiable requirement not to charge a fee that is egregiously out of line with industry norms. To apply Gartenberg in this fashion

investment firms, employee at financial-services companies, founder of an investment consulting firm, and board member of investment advisers. Chuck Jaffe, The Mutual Fund Industry Is a Little Worse Off Today, WALL ST. J. (July 23, 2014), http://www.marketwatch.com/story/the-mutual-fund-industry-has-lost-a-voice-of-reason-2014-07-23. Noting the importance of Bobroff’s advice to mutual fund investors, Jaffe reported that Bobroff taught “that if you are not a sharp investor, savvy enough to handle it yourself and with sufficient dollars to build a diversified portfolio without using mutual funds, then the fund world was a necessary evil.” Id. But Jaffe explained that Bobroff “was openly critical of boards with little independence and close ties to management, the kind where a manager’s contract gets rubber-stamped year after year despite reviews which couldn’t possibly ignore problems with underperformance,” noting “just how hard it can be for directors to remove a fund manager.” Id. Jaffe explained that Bobroff cautioned investors about fees: “Fund firms are very interested in your money—or at least the cut they get for managing it—but they are more interested in their own . . . [If] you could wonder whether a fund’s actions have your best interest at heart, you could assume they didn’t.” Id.

158. Gallus, 561 F.3d at 821-23.


160. Gallus, 561 F.3d at 822.

161. Id. at 822-23 (emphasis added).
across the entire mutual fund market would be to eviscerate § 36(b).^{162}

Following through with its admonition against having a merely abstract understanding of the law, the court postulated that the failure to understand how to apply the Gartenberg framework properly “may explain why no plaintiff has ever obtained a judgment in an action brought under that provision.”^{163} One key additional requirement to the proper application of the Gartenberg framework, the court explained, is that courts must analyze “both the adviser’s conduct during negotiation and the end result.”^{164}

Reversing the grant of summary judgment in favor of the investment adviser, the court held that the district court’s analytical error was not in applying the Gartenberg framework “for the limited purpose of determining whether the fee itself constituted a breach of fiduciary duty, [but] it erred in rejecting a comparison between the fees charged to [the adviser]’s institutional clients and its mutual fund clients.”^{165} The court validated the shareholder’s argument to compare fund fees with institutional account fees, characterizing it as “particularly strong in this case because the investment advice may have been essentially the same for both accounts.”^{166} Along those lines, the court alerted investment advisers and courts that “tethering fees to an industry median will not provide sure-fire protection from § 36(b) liability.”^{167} Notably, the court agreed with the frequently aired concern that the judiciary should not become rate-setters in the mutual fund industry by substituting its judgment for the boards tasked with setting fees.^{168}

The Eighth Circuit reversed the grant of summary judgment against the fund shareholders, making it appear as though the shareholders would have a chance to prove at trial that their investment adviser had breached its fiduciary duty as to fees. Any semblance of victory, however, was short-

162. *Id.* at 823.

163. *Id.* at 823 & n.4 (citing Lyman Johnson, *A Fresh Look at Director “Independence”: Mutual Fund Fee Litigation and Gartenberg at Twenty-Five*, 61 VAND. L. REV. 497, 519 (2008) (noting that no investor has obtained a verdict against an investment adviser in the twenty-five years since Gartenberg)).

164. *Id.*

165. *Id.*

166. *Id.* at 824; see Jones v. Harris Assocs. L.P., 537 F.3d 728, 731 (7th Cir. 2008) (Posner, J., dissenting from denial of petition for rehearing en banc) (cautioning that “[a] particular concern in this case is the adviser’s charging its captive funds more than twice what it charges independent funds.”).


168. *Id.*
lived. The Supreme Court of the United States later vacated the Eighth Circuit's Gallus decision and remanded the case for further consideration in light of Jones, a case discussed shortly. Upon remand, the district court that had originally dismissed the shareholders' claims once again granted summary judgment for the investment advisers. In light of Jones, the Eighth Circuit capitulated on the second appeal, affirming the dismissal.

5. Supreme Court Enters the Fray, Confirms Gartenberg Generally

And so stood the section 36(b) landscape in the spring of 2009. The last word on section 36(b)'s fiduciary duty standard did not, however, come from the Second Circuit, Seventh Circuit, or Eighth Circuit. In 2010, the Supreme Court entered the fray to answer "what a mutual fund shareholder must prove in order to show that a mutual fund investment adviser breached" its section 36(b) fiduciary duty. In Jones v. Harris Associates L.P., the Court generally adopted the Gartenberg analytical framework. But the Court perpetuated the long-standing problem that the framework is purely theoretical and illusory. There continues to be no practical, adjudicated illustration of how fund shareholders can prove a violation of section 36(b).

a. Oral arguments focus on governing standard and its application

Before explaining the Court's decision in Jones, it is prudent to review the transcript of oral argument. Although arguments probably do not reveal exactly what individual justices are personally thinking, this exercise reveals how the justices openly struggled with understanding the governing legal standard that protects section 36(b)'s fiduciary duty and, more importantly, in knowing how to apply that standard in an actual case.

Justice Anthony M. Kennedy openly struggled to determine what Congress intended by placing a fiduciary duty as to fees on investment advisers. So, too, did Justice John Paul Stevens. Both justices were

173. Id. at 353.
175. Id. at 4-6, 11, 18-19:
trying to determine how significant the fiduciary duty is. This entire debate harkens back to the most famous words ever written about the fiduciary duty standard. While a justice on the Court of Appeals of New York, Justice Benjamin N. Cardozo famously set an extremely high standard of care for fiduciaries under trust law:

Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm’s length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the “disintegrating erosion” of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a

Is [the investment adviser] a fiduciary in the same sense as a corporate officer and a corporate director? Or does his fiduciary duty differ? Is it higher or lower, same with a guardian, same with a trustee? . . . Does fiduciary imply different standards, depending on what kind of fiduciary you are? . . . Well, would the test for compensation in this case be the same as any director or any officer of a corporation? . . . Is the fiduciary standard the same, without getting into how its [sic] applied? Is the fiduciary standard the same for Jones, for a guardian, for a trustee, for a corporate officer or a corporate director, always the same? . . . You said that Congress used “fiduciary” in a special sense. Then . . . I have to conclude that your earlier answer is confusing for me, because I thought you were going to tell us that this investment adviser has the same fiduciary standard that officers and directors of corporations have. Then you say that Congress used it in this special sense. So that doesn’t quite square. . . . Do you think Congress used the term “fiduciary” in a very special sense here? I will just tell you the problem I’m having with the case. If I look at a standard that the fees must be reasonable and I compare that with what a fiduciary would do, I thought a fiduciary has the highest possible duty. But apparently the submission is the fiduciary has a lower duty, a lesser duty than to charge a reasonable fee. I just find that quite a puzzling use of the word “fiduciary.” Now, if Congress uses it as a term of art or in some special sense, fine . . . But it seems to me an odd use of the term “fiduciary.” I don’t know why Congress didn’t use some other word.

176. Id. at 27 (“Do you think the fiduciary status of the defendant in this case is different from the fiduciary status of a president of a corporation?”).
level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.177

Unfortunately, it seems like Justice Cardozo’s famous fiduciary duty standard failed to lend support to the Court’s discussion of the Gartenberg standard. As explained below, the Court generally interpreted section 36(b)’s fiduciary duty by adopting the Gartenberg standard.

Importantly and critically, however, the focus of oral arguments turned from a discussion of the legal standard itself to a discussion of how to apply the fiduciary duty standard to actual facts. Justice Ruth Bader Ginsburg focused her questions on the proper comparison between the fees charged and the actual services rendered.178 The fund shareholders’ attorney responded that a disputed issue of fact was whether the services provided to institutional clients were greater than those provided to fund clients, even though fund clients were charged more.179

Chief Justice John G. Roberts sought to understand how the fiduciary duty standard applied to determine a lawful range of fees: “what if the adviser had given such good advice that the fund beat the industry average for his category of fund by five percent over the last five years. Does he get double the normal compensation of the average fees? Does he get triple? Fifty percent more? How is the court supposed to decide that?”180 The shareholders’ attorney answered that when investment advisers buy the same stocks and achieve the same performance for both institutional and fund clients, then “there is no reason why the mutual fund should be charged twice as much.”181

Justice Sonia Sotomayor provided analytical precision in focusing the argument on “what everyone’s skirting around, which is what’s the proof that a particular transaction is not arm’s-length?”182 The fund shareholders’

177. Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928) (emphasis added) (citations omitted). I think that it is fair to conclude that Justice Cardozo’s view of fiduciary duty differs dramatically from Judge Easterbrook’s.

178. Transcript of Oral Argument at 8, Jones, 559 U.S. 335 (No. 08-586) (“But there was in this record, was there not, a submission by the adviser comparing what mutual funds this fund was charged, what institutional funds were charged, but explaining the differential in terms of the services provided, that more services were provided to the fund and less services were provided to the institutional investors.”). 

179. Id.

180. Id. at 9-10.

181. Id. at 10.

182. Id. at 15. It might be prudent, at some level, to recognize that Justice Sotomayor was born in New York, worked in the New York County District Attorney’s Office, litigated commercial cases in a New York City law firm, served as a federal trial judge in the United
attorney responded, "Fair against what the adviser actually charged for same or similar services to an outsider who had the right to walk away." 183 Echoing this argument, the Solicitor General explained that the Court's duty was not simply "to establish what the single most reasonable fee would be," but instead "whether the bargain fell within the range of what arm's length bargaining otherwise would have achieved." 184 Justice Sotomayor asked the critical questions, "how much deviance, and what is the scope of the range?" 185 The Solicitor General replied:

I think that the term of art of "fiduciary duty" doesn't necessarily demonstrate how much deviance away from the range there would be. I think that depending upon the segment of the market[,] the range might be more or less narrow. In segments of the market where services are more commodified and standardized, perhaps with index funds, there might be a much narrower range of fees that are arrived at through arm's-length bargaining, and even—and smaller disparities might be inappropriate there. 186

Justice Antonin Scalia questioned whether courts always must decide the reasonableness of an advisory fee, even in cases with full disclosure. 187 The Solicitor General answered yes, explaining that courts must "decide whether the plaintiff has met its burden of proving that [the fee] falls outside the range of fees that arm's-length bargaining would have arrived at." 188 The rationale for this position was Congress's intent to counteract the inherent

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183. Transcript of Oral Argument at 16, Jones, 559 U.S. 335 (No. 08-586).
184. Id. at 20.
185. Id. at 26.
186. Id.
187. Id. at 25.
188. Id.
structural impediments in the mutual fund industry that prohibit arm's-length negotiations between investment advisers and mutual fund boards.189

Justice Sotomayor again pressed for an illustration of how an investment adviser actually could breach its fiduciary duty:

[L]et's assume that all of the independent board of director members vote for a particular fee, but the fee is negotiated by an insider, and the insider is the one who does the evaluation, looks at them and says: I think this is really a great deal, guys. And they just fell for it. Is that a process that would guarantee an arm's-length transaction in the sense that Congress intended in [the ICA]?190

Undeterred, the investment adviser's attorney countered:

It may not and it may give rise to a cause of action. . . . It may give a cause of action under section 36(b) if the circumstances you described, Justice Sotomayor . . . have an impact upon the fee. . . . If there is an impact upon fee that is outside of the range of what could have been bargained.191

Well, that certainly clears it up, doesn't it? That is, the advocate's response was a ridiculously circular non sequitur. He should have just responded that yes, indeed, those circumstances would definitely produce a section 36(b) violation, but only if section 36(b) actually had been violated. And the circularity could have continued unabated and unabashed!

As oral arguments honed in on how to determine an acceptable, lawful range, the answers became increasingly vague and unhelpful. Trying to find evidence of the acceptable range that would satisfy the investment adviser's fiduciary duty, Chief Justice Roberts asked if "ten percent off," "fifty percent off," or "[d]ouble, as they say is the case here," is "so far out of bounds."192 Evading a precise response, the investment adviser's attorney seemingly created a safe harbor for all investment advisers: "I suggest there is no numerical basis, because in fact every kind of mutual fund and [every] stripe of mutual fund is different."193 Chief Justice Roberts pressed, "Well, then you say: Look to see if it's outside the bounds, and now you tell me there

189. Id. at 27.
190. Id. at 28.
191. Id. at 28-29.
192. Id. at 31-32.
193. Id. at 32.
is no way to look to see if it's outside the bounds." Undeterred, the oralist replied with an illustration:

Well, I think . . . the first comparative would be other funds of a similar stripe. So, for example, you could imagine that a mutual fund with the same investment objective and style that is two times might be inappropriate. You could also imagine a different circumstance where, passively managed funds for example, a multiple of fees would be inappropriate.

You could also, though, imagine a case where there is substantial risk taken, where the types of securities that are invested in are unusual, where substantial differences could be justified.

Okay, so now do you understand precisely when an investment adviser breaches its fiduciary duty? Finally, the fund shareholders’ attorney exasperated, "we had to prove a negative, which is not ordinarily what a plaintiff has to prove in any law case, by showing [that an advisory fee] . . . is so disproportionate it could not have been achieved at arm’s-length."

b. Unanimous Supreme Court decision in Jones updates Gartenberg

In its Jones decision, the Supreme Court began its discussion by recognizing the unique structure that dominates much of the mutual fund industry—investment advisers routinely create mutual funds, choose the funds’ board of directors, make the funds’ investments, and provide most services to the funds, all while knowing that most funds do not have the practical ability to sever their relationships with their advisers. Importantly, the Court appreciated that “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.” To that end, the Court grasped that section 36(b)’s fiduciary duty was not plucked out of thin air, but was enacted in response to this reality.

The Court next explored the legislative history and purpose behind section 36(b). The Court also cataloged the tremendous growth enjoyed

194. Id. (emphasis added).
195. Id. at 32-33.
196. Id. at 50. That observation might be worth exploring further, but just not in this Article.
198. Id. (quoting S. Rep. No. 91-184, at 5 (1969)) (internal quotation marks omitted).
199. Id. at 339-41.
by the mutual fund industry in the past half-century, explaining that during this time “something of a consensus” had formed within the federal judiciary that the Gartenberg analytical framework—its standard and factors—was good law.\textsuperscript{200} Highlighting Jones's procedural history, the Court noted that the Seventh Circuit's panel opinion had created a circuit split in need of resolution.\textsuperscript{201}

The Court made my day when it declared that the meaning of section 36's fiduciary duty standard “is hardly pellucid” and that the Gartenberg standard “may lack sharp analytical clarity.”\textsuperscript{202} In general, the unanimous Court\textsuperscript{203} blessed what the lower federal courts (with the sole exception of the Seventh Circuit) had been blessing for decades—the Second Circuit's creation of the proper analytical framework in Gartenberg.\textsuperscript{204}

First, the

\begin{itemize}
  \item \textsuperscript{200} \textit{Id.} at 343-46.
  \item \textsuperscript{201} \textit{Id.} at 342-43 \& n.2 (citing Jones, 527 F.3d 627; Migdal v. Rowe Price-Fleming Int'l, Inc., 248 F.3d 321 (4th Cir. 2001); Krantz v. Prudential Invs. Fund Mgmt. LLC, 305 F.3d 140 (3d Cir. 2002); Gallus v. Ameriprise Fin., Inc., 561 F.3d 816 (8th Cir. 2009)).
  \item \textsuperscript{202} \textit{Id.} at 345, 353. In response, I can only gasp. “You think?” As this Article posits, if a legal standard cannot be illustrated as to how it applies factually, then it is a monumental understatement to refer to it as pellucid and lacking in sharp analytical clarity.
  \item \textsuperscript{203} Writing separately in a concurring opinion, Justice Clarence Thomas quibbled on whether the Court actually blessed the Gartenberg standard: “But I would not say that ... we endorse the 'Gartenberg standard.' Whatever else might be said about today's decision, it does not countenance the free-ranging judicial 'fairness' review of fees that Gartenberg could be read to authorize.” \textit{Id.} at 354-55 (Thomas, J., concurring).
  \item \textsuperscript{204} \textit{Id.} at 343-46. Not only had the Court recognized that nearly the entire federal judiciary had been on board with the Gartenberg framework, the Court also recognized that the SEC had been as well. \textit{Id.} at 344; see 17 C.F.R. § 240.14a-101, Sched. 14A, Item 22, Para. (c)(11), which requires the board of directors to adhere to the following Gartenberg-like regulations in selecting an investment adviser and approving the adviser's fees:
    - Discuss in reasonable detail the material factors and the conclusions with respect thereto that form the basis for the recommendation of the board of directors that the shareholders approve an investment advisory contract.
    - Include the following in the discussion:
      \begin{itemize}
        \item (i) Factors relating to both the board's selection of the investment adviser and approval of the advisory fee and any other amounts to be paid by the Fund under the contract. This would include, but not be limited to, a discussion of the nature, extent, and quality of the services to be provided by the investment adviser; the investment performance of the Fund and the investment adviser; the costs of the services to be provided and profits to be realized by the investment adviser and its affiliates from the relationship with the Fund; the extent to which economies of scale would be realized as the Fund grows; and whether fee levels reflect these economies of scale for the benefit of Fund investors. Also indicate in the discussion whether the
Court concluded that the Gartenberg standard “was correct in its basic formulation”:

to face liability under § 36(b), an investment adviser must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm’s length bargaining.  

Second, the Court generally welcomed the Gartenberg factors as having the analytical ability to properly carry out the Gartenberg standard’s determination of whether section 36(b)’s fiduciary duty has been violated in a particular case.  

After agreeing with Gartenberg’s basic analytical framework, the Court explained the importance of placing section 36(b)’s fiduciary duty within the larger context of how the ICA regulates investment advisers. The “cornerstone” of the ICA is built on requiring a fully informed board to scrutinize the adviser and its fee, while also ensuring that disinterested board members serve as “independent watchdogs” on behalf of fund shareholders. To carry out these demands, the ICA then requires that

board relied upon comparisons of the services to be rendered and the amounts to be paid under the contract with those under other investment advisory contracts, such as contracts of the same and other investment advisers with other registered investment companies or other types of clients (e.g., pension funds and other institutional investors). If the board relied upon such comparisons, describe the comparisons that were relied on and how they assisted the board in determining to recommend that the shareholders approve the advisory contract; and  

(ii) If applicable, any benefits derived or to be derived by the investment adviser from the relationship with the Fund such as soft dollar arrangements by which brokers provide research to the Fund or its investment adviser in return for allocating Fund brokerage.

205. Jones, 559 U.S. at 346.

206. See id. at 344 & n.5 (quoting Gartenberg, 694 F.2d at 929-32) (listing the Gartenberg factors as follows: “[1] the adviser[]’s cost in providing the service[,] . . . [2] the extent to which the adviser[] realizes economies of scale as the fund grows larger[,] . . . [3] the volume of orders which must be processed by the [adviser] . . . . [4] the nature and quality of the services provided to the fund and shareholders; [5] the profitability of the fund to the adviser; [6] any ‘fall-out financial benefits,’ those collateral benefits that accrue to the adviser because of its relationship with the mutual fund; [7] comparative fee structure (meaning a comparison of the fees with those paid by similar funds); and [8] the independence, expertise, care, and conscientiousness of the board in evaluating adviser compensation.”).

207. Id. at 348-49.

208. Id. at 348.
advisers furnish the board with all information needed to make informed decisions on fees.\textsuperscript{209} Finally, the ICA authorizes causes of action for the SEC and fund shareholders to independently reinforce the investment adviser’s fiduciary duty.\textsuperscript{210}

Focusing on the Gartenberg factors, the Court explained that the Second Circuit was a bit too stingy when it rejected evidence that compared the fees the adviser charged to mutual funds with the fees charged to pension funds.\textsuperscript{211} Understanding that the ICA requires that all relevant factors be considered when analyzing section 36(b) claims, the Court declared that there can be no “categorical rule regarding the comparisons of the fees charged different types of clients.”\textsuperscript{212} Instead, the Court gave the green light for courts to consider and understand fully the similarities and differences between what the adviser charges its funds and institutional clients as well as the services that the adviser provides to those different types of clients.\textsuperscript{213} Obviously, if the services to both types of clients are comparable, then the comparison of fees is more probative; if the services are widely disparate, then fee comparisons become largely irrelevant.\textsuperscript{214}

Again demonstrating its complete understanding of the unique, conflict-ridden organizational structures found in the mutual fund industry, the Court stressed that federal “courts should not rely too heavily on comparisons with fees charged to mutual funds by other advisers . . . because these fees, like those challenged, may not be the product of negotiations conducted at arm’s length.”\textsuperscript{215} It seems like common sense to realize that if the fees that a slew of investment advisers charge their captive mutual funds do not reflect robust, arm’s-length negotiations, then, in the face of that knowledge, a court’s simple comparison of the fees charged to each captive fund could not logically determine whether any of the advisers had breached its fiduciary duty. To be sure, the lack of arm’s-length negotiations industry-wide would simply create a floor of fees that would never be vulnerable to section 36(b)’s fiduciary duty. This point was lost on the Seventh Circuit, but the Supreme Court fully grasped this reality.

The Court emphasized that the process under which board members—and particularly independent board members—review the investment

\textsuperscript{209} Id.
\textsuperscript{210} Id.
\textsuperscript{211} Id. at 349-51.
\textsuperscript{212} Id. at 349.
\textsuperscript{213} Id. at 349-50.
\textsuperscript{214} See id. at 350.
\textsuperscript{215} Id. at 350-51.
adviser's fees is relevant.\textsuperscript{216} The more informed and robust the board's review, the more deference a court should give the board's fee determination.\textsuperscript{217} When a board's process is deficient or when the board lacks relevant information, additional scrutiny of the fee is justified.\textsuperscript{218} Notwithstanding the amount of deference, however, a court's responsibility is to always consider the substance of the fee.\textsuperscript{219}

No matter what the evidence shows as to the robustness of the board's review of the information provided or fee charged, the Court cautioned that the structure of the federal judiciary also militates against a false conclusion that judges are somehow magically equipped to determine the appropriate fee structures for the mutual fund industry.\textsuperscript{220} The Court made clear that section 36(b) "does not call for judicial second-guessing of informed board decisions."\textsuperscript{221} Even with the multitude of potential conflicts of interests within the mutual fund industry, the Court explained that federal judges are still not given the authority—because they do not have the ability—to "supplant the judgment of disinterested directors apprised of all relevant information, without additional evidence that the fee exceeds the arm's-length range."\textsuperscript{222} To clarify the federal judiciary's limited role, the Court explained that an analysis of section 36(b) claims "does not require courts to engage in a precise calculation of fees representative of arm's-length bargaining."\textsuperscript{223}

Because the Supreme Court generally adopted the Gartenberg standard and factors, the landscape surrounding section 36(b) really did not change because of the decision in Jones. The same clearly articulated legal standard and factors still exist. It is equally true, however, that no court has applied these standards and factors to a set of facts to illustrate a breach of an investment adviser's fiduciary duty.

\begin{itemize}
\item \textsuperscript{216} Id. at 351.
\item \textsuperscript{217} Id.
\item \textsuperscript{218} Id. at 351-52.
\item \textsuperscript{219} Id. at 350-51.
\item \textsuperscript{220} Id. at 352-53.
\item \textsuperscript{221} Id. at 352.
\item \textsuperscript{222} Id.
\item \textsuperscript{223} Id. at 352-53 (citing Jones v. Harris Assocs. L.P., 527 F.3d 627, 633 (7th Cir. 2008) ("Judicial price-setting does not accompany fiduciary duties . . . ."); Gen. 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.") (alteration in original)).
\end{itemize}
C. Lessons Learned from Judicial History: Taking Stock of Where We Are

Let's take stock of five things that we know. First, the Seventh Circuit’s conservative, free-market approach with little judicial oversight was soundly and unanimously rejected by the Supreme Court. It seems that Judge Easterbrook’s overdose on free-market principles clouded his interpretation of section 36(b)’s fiduciary duty. He could not see that section 36(b)’s purpose was to counter the structural conflicts of interest in the mutual fund industry that eliminate arm’s-length bargaining on fees. Instead of interpreting actual federal law that regulated the fee relationship between mutual funds and investment advisers, Judge Easterbrook interpreted the federal law that he would have voted for had he been a member of Congress. His approach is not the law.224

Second, a liberal panacea in which federal judges act as hyperactive rate-setters in determining the appropriate and most reasonable fee in every mutual fund setting was soundly and unanimously rejected by the Supreme Court. Courts must judicially defer to the fee-bargaining process when it produces arm’s-length results.

Third, the Supreme Court rejected a fully conservative, free-market approach and a fully liberal, judicial rate-setting approach, instead incorporating a little bit of both approaches. Inherently rejecting an “either-or” approach for a “both-and” approach, the Court recognized that Congress’s decision to regulate capital markets by enacting section 36(b)’s fiduciary duty did not entirely leave fee-setting to the free market, but instead made the investment adviser’s fee-setting subject to a judicially enforceable fiduciary duty. The judicially enforceable fiduciary duty, however, has built-in deference to mutual fund boards that actually engage in arm’s-length negotiations over fees while armed with all relevant information.

Fourth, the decades-old Gartenberg analytical framework (including its standard and factors) that interprets and applies section 36(b)’s fiduciary duty was generally approved by the Supreme Court. That means everything that we have not learned in the past four decades is still relevant to what we do not know today. I am being facetious, but the point is that caselaw provides a pretty good idea of what type of behavior does not violate section 36(b)’s fiduciary duty. No caselaw illustrates the type of behavior that runs afoul of section 36(b).

224. Judge Easterbrook’s concept of fiduciary duty could not be farther from Justice Cardozo’s. Instead of viewing fiduciary duty as the highest standard known to the law, Judge Easterbrook took a contrary view by placing an investment adviser’s fiduciary duty just above the obligation to avoid criminal fraud.
Fifth, it is prudent to realize that a unanimous Supreme Court decided Jones. Without congressional intervention, section 36(b)'s fiduciary duty will be subject to the Gartenberg-Jones standard and analytical factors. The analytical framework and governing legal standard have been set; it is doubtful that any change will come from Congress or the Supreme Court. The only remaining question—which has gone unanswered for a long time—is what facts will meet the standard to discover a violation of section 36(b).225

As we enter 2015, it certainly seems as if we have not moved much at all since the Second Circuit issued its Gartenberg decision in 1982. The federal judiciary, by and large, has followed the Gartenberg standard and factors for the past three decades. There really has never been an urgent need for clarification of the standard and factors used to interpret section 36(b)'s fiduciary duty. The Gartenberg standard and factors have been clearly articulated all along. What has been missing is an adjudicated illustration of how the law applies to a real case in which the standard is found to have been violated.226 We have a precise fiduciary duty with a clear legal standard as well as easily understood factors without so much as a clue as to how that law produces a violation of section 36(b). To that extent, we are no closer to finding an adjudicated illustration of a violation of section 36(b) in 2015 than we were in 1982.227

225. Let me make a common-sense observation. I believe intuitively that not every investment adviser provides above-average services to warrant above-average fees. By definition, approximately half of investment advisers will provide above-average services while the other half will provide below-average services. It is logical to then assume that the investment advisers who provide above-average services lawfully can charge above-average fees and, likewise, that investment advisers who provide below-average services lawfully could not charge anything other than below-average fees. That would seem to be how free-market, arm's-length bargaining would present itself in the absence of structural impediments to such bargaining.

226. "Though Congress enacted [section] 36(b) because it recognized the potential for abuse and wanted to empower shareholders to police excessive fees, section 36(b) is impotent in practice. Because of the impractical proof standard for succeeding in a [section] 36(b) lawsuit, no plaintiff has ever won a fee case brought under section 36(b)." John P. Freeman, Stewart L. Brown, & Steve Pomerantz, Mutual Fund Advisory Fees: New Evidence and a Fair Fiduciary Duty Test, 61 OKLA. L. REV. 83, 86 (Spring 2008).

227. Let's take a stroll down memory lane to remind ourselves that 1982 was a long time ago. Here are a few things that happened in 1982: the Color Purple was published; Star Trek II: The Wrath of Khan was released; Bernie Madoff began implementing a new options strategy for his investment business; a baby named Kate Middleton was born at Royal Berkshire Hospital in the United Kingdom; John Belushi died; the North Carolina Tar Heels defeated the Georgetown Hoyas in the NCAA Men's Division I Basketball Tournament, and a skinny freshman named Michael Jordan nailed the game-winning shot with only seventeen
To amplify how strange it is for the law to be in this predicament of unpredictability, imagine if a traveler wanted to find the way to a destination, it would be wise to get directions to the exact location. It would be less than helpful and altogether frustrating for someone to try to lend a hand by giving the traveler directions to five different locations that are not to the destination that he is seeking. Similarly, a comedian will face a difficult task of making people laugh if he only knows what is not funny, rather than what is funny. These backward scenarios seem to be where we find ourselves with respect to section 36(b) litigation. We have a pretty good idea of what does not constitute valid section 36(b) claims, kind of like the traveler who only gets directions to places he is not going or a comedian who is given lots of material that is not funny. But we do not have a strong sense of what constitutes a valid section 36(b) claim.

This Article does not seek to change the federal law of an investment adviser’s fiduciary duty to one side or the other of the debate that has raged for half a century. This Article does not clamor to loosen the fiduciary duty standard to allow the free market unfettered and unregulated reign over advisory fees or the relationship between mutual funds and investment advisers. Also, this Article does not contend that judicial fee-setting or rate-regulation should be the law. Instead, this Article takes the law as it exists in its current state, as interpreted by the federal judiciary for decades and recently by a unanimous Supreme Court. The focus of this Article is to demonstrate that a federally protected fiduciary duty is utterly worthless, even if recited as a clearly articulable legal standard, until real-world facts illustrate and compel a legal conclusion that an investment adviser violated section 36(b) by breaching its fiduciary duty with respect to advisory fees. Until that moment, section 36(b) will remain an illusory and unjust law. The next section explores a few cases that, as always, resulted in victories for investment advisers.

V. JUDICIAL ILLUSTRATIONS OF WHAT DOES NOT CONSTITUTE A BREACH OF SECTION 36(B)’S FIDUCIARY DUTY—THAT IS THE BEST WE HAVE

No matter what the Eighth Circuit concluded in Gallus or what Judge Posner wrote in his dissent in Jones, no court has entered judgment against an investment adviser for violating section 36(b). Over three decades ago in the seminal Gartenberg case, the Second Circuit uttered a bold statement

seconds left in the game; Steven Spielberg's E.T. The Extra-Terrestrial was released; Michael Jackson released his mega-hit Thriller; and Bill Clinton was re-elected as Governor of Arkansas. What Happened in 1982, WORLD HISTORY PROJECT, http://worldhistoryproject.org/1982/page/1 (last visited Dec. 20, 2014).
that Congress intentionally created an unclear legal standard that would govern the protection afforded to fund shareholders against excessive fees charged by investment advisers: "[Congress made] no attempt to set forth a definitive test by which observance or breach of fiduciary duty was to be determined." Of course, the Second Circuit’s pronouncement was intended to show that Congress left to the federal judiciary the task of filling in the blanks in creating a legally enforceable standard to unlock section 36(b)’s protections. I have no doubt that the Second Circuit thought that its Gartenberg standard and factors would lay the foundation for establishing investment adviser liability for breaching section 36(b)’s fiduciary duty. Unfortunately, neither Congress nor the federal judiciary has “set forth a definitive test by which observance or breach of fiduciary duty [has been] determined.” Even though section 36(b)’s fiduciary duty and the Gartenberg standard and factors readily provide the proper analytical framework that routinely reveals when investment advisers observe their fiduciary duties, we are left wanting an adjudication of a contested case in which an investment adviser breaches its fiduciary duty. Over the next few pages, this Article provides some illustrations of cases in which investment advisers have prevailed. This exercise will equip you to at least know when courts have ruled in favor of investment advisers; it will not illustrate when fund shareholders win.

A. Green v. Fund Asset Management, L.P.

In Green v. Fund Asset Management, L.P., the United States Court of Appeals for the Third Circuit confronted the issue of whether “a fee arrangement in which a fund’s investment advisors have an incentive to maximize leverage in order to increase their advisory fees is not a per se breach of an investment advisor’s fiduciary duties under § 36(b) of the ICA.” Concluding that it is “clear that potential conflicts of interest in mutual fund fee arrangements are not per se violations of investment advisors’ fiduciary duties,” the court held that “an actual breach must be alleged and proven.”

In Green, shareholders in municipal bond funds sued their investment advisers for violating their section 36(b) fiduciary duties. The investment

228. Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 694 F.2d 923, 928 (2d Cir. 1982).
230. Id. at 684.
231. Id. at 684-85.
232. Id. at 683.
advisers employed a strategy to increase yield by employing leverage.\textsuperscript{233} This strategy allowed the advisers to raise additional capital by selling preferred stock to then deploy into long-term bonds.\textsuperscript{234} For its services, the investment adviser charged a fee of .5\% percent of fund assets.\textsuperscript{235} Fund shareholders alleged "that because the bonds purchased with the proceeds from the sale of preferred shares are included in the corpus of assets upon which the advisory fee is based, [the investment advisers] have a strong financial incentive to keep the Funds fully leveraged," which "creates an actual conflict of interest between the Funds and their advisors that amounts to a \textit{per se} breach of fiduciary duty under § 36(b)."\textsuperscript{236}

Even after recognizing that conflicts of interest inherent in the mutual fund industry were the impetus for Congress's enacting section 36(b), the court nonetheless rejected the shareholders' claim by declaring "that § 36(b) was intended to provide a \textit{very specific, narrow} federal remedy."\textsuperscript{237} Because fund shareholders failed to identify an instance when the investment advisers "improperly failed to de-leverage the Funds in order to maximize their fees and because plaintiffs have not alleged any actual damages they . . . suffered as a result of any improper decision by the Funds' investment advisors,"\textsuperscript{238} the court affirmed the district court's granting of summary judgment to the investment advisers.\textsuperscript{239}

B. In Re Goldman Sachs Mutual Funds Fee Litigation

The case of \textit{In re Goldman Sachs Mutual Funds Fee Litigation}\textsuperscript{240} illustrates another way for an investment adviser to prevail. In that case, a federal trial court showcased an investment adviser to various Goldman Sachs mutual funds who provided daily advice on portfolio transactions, was paid fees based on a percentage of the funds' total assets, and selected brokers for the funds' transactions.\textsuperscript{241} Fund shareholders sued their investment advisers for violating section 36(b).\textsuperscript{242} The gravamen of the

\textsuperscript{233} \textit{Id}.
\textsuperscript{234} \textit{Id}. at 683-84.
\textsuperscript{235} \textit{Id}. at 684.
\textsuperscript{236} \textit{Id}.
\textsuperscript{237} \textit{Id}. at 685 (emphasis added).
\textsuperscript{238} \textit{Id}. at 686.
\textsuperscript{239} \textit{Id}. at 683.
\textsuperscript{240} No. 04 Civ. 2567(NRB), 2006 WL 126772 (S.D.N.Y. Jan. 17, 2006).
\textsuperscript{241} \textit{Id}. at *2.
\textsuperscript{242} \textit{Id}. Shareholders also brought a bevy of other claims against various defendants, alleging violations of other provisions of the ICA and the Investment Advisers Act, breaches
shareholders’ complaints was that the investment adviser charged the funds excessive fees so that it could fund “kickbacks” or payments to brokerages that would steer investors into the funds. The criticism was that the fees charged to the funds were not for services that benefitted shareholders, but rather were simply to increase fund assets that would be subject to the percentage that the investment adviser charged for its services, i.e., as new investors flooded the funds with money, advisory fees would explode. The investment adviser defended its practice by contending that as assets under management increased, the adviser could share the benefits of these economies of scale with the funds. Shareholders countered that there was no evidence that the benefits of such economies of scale were ever shared with the funds, claiming that fees actually increased as fund assets rose due to the adviser’s “practice of ‘skim[ming]’ from the Funds to finance its ‘marketing campaign.”

These factual allegations were not enough to survive the investment adviser’s motion to dismiss. After reciting the Gartenberg standard and factors, the court determined that “pleading standards” dictate that the court need not even analyze the factual allegations under the Gartenberg factors. Bypassing any use of the Gartenberg factors, the court determined that a sufficiently pled section 36(b) claim required an allegation of facts that would prove “that the fees are disproportionately large, that they bear no reasonable relationship to the services rendered or that they could not have been the product of arm’s-length bargaining.” That is, the court simply restated the Gartenberg standard as a pleading standard without any analysis of the underlying factors. The court chastised the shareholders that their complaint must not simply make conclusory allegations that advisory

of fiduciary duties under state law, and unjust enrichment. Id. at *4. Shareholders lost on all claims. Id. at *12.

243. Id. at *2.

244. Id. at *2-3.

245. Id. at *3.

246. Id. Fund shareholders alleged that while the funds' net assets increased from $92.2 million to $146.8 million (purportedly driving economies of scale), the net asset value per share dropped from $12.52 to $7.79 while the “ratio of net expenses to average net assets [actually] increased from 1.44% to 1.45%.” Id.

247. Id. at *7-10.

248. Id. at *8-9 (citing Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 694 F.2d 923, 928 (2d Cir. 1982)).

fees are excessive, but must actually allege facts that would prove that the fees are excessive.250

By simply reading the complaint, the court concluded that the shareholders’ allegations could not prove excessive fees in violation of section 36(b). The court determined that the fund shareholders’ failure to explain in their complaint “the relationship between the advisory fees and the services rendered [was] fatal to their claim.”251 The court cautioned, “Mere assertions that fees increased with the size of the Funds are not enough to establish that the benefits from economies of scale were not passed on to investors.”252 The essence of the court’s holding is that the allegations never tied the fees charged to the services provided, rendering it impossible to legally conclude that the fees were excessive.253


This approach sounds a common refrain among federal courts. According to the United States Court of Appeals for the Fourth Circuit in Migdal v. Rowe Price-Fleming International, Inc.,254 a generalized, speculative breach of fiduciary duty claim will not allow a legal conclusion that section 36(b) has been violated.255 Instead of making general allegations or conclusory pleadings, the court explained that fund shareholders must allege facts “that, if true, would support a claim that the fees at issue are excessive.”256 Specifically, “to determine whether a fee is excessive for purposes of Section 36(b), a court must examine the relationship between the fees charged and the services rendered by the investment adviser.”257 Affirming the summary dismissal, the court concluded that fund shareholders failed to allege facts that would allow the court to explore the relationship between fees and services.258 Even though shareholders challenged the amount of the fees, the shareholders’ fatal mistake was

250. Id.
251. Id.
252. Id.
253. Id. at *9-10.
254. 248 F.3d 321 (4th Cir. 2001).
255. Id. at 327-28.
256. Id. at 327.
257. Id. (emphasis added); see Krantz v. Prudential Inv. Fund Mgmt., LLC, 305 F.3d 140, 143 (3d Cir. 2002).
258. Migdal, 248 F.3d at 327.
failing to include in the complaint "facts about the services that defendants offered in return for those fees."²⁵⁹

What were the facts that led the court in Migdal to affirm summary dismissal without allowing discovery? Mutual fund shareholders sued their investment advisers for breach of fiduciary duty in violation of section 36(b) based on these allegations: (1) "the amount of fees charged by the two funds"; (2) "two or three similar funds offered lower fee rates than the funds in this case, while simultaneously outperforming them"; (3) "the two funds in question did not meet their preselected benchmark performance standards"; and (4) "despite the funds' underperformance, the . . . investment advisers' earnings increased by more than 20 percent."²⁶⁰ The failure to allege facts about the services offered that earned those fees was fatal.²⁶¹

The fund shareholders' main contention was that a "funds' performance is the ultimate proxy for the services offered by the investment advisers[,] because] if a fund underperforms, the services of its investment adviser are worth less than those offered by the investment adviser of a better performing fund."²⁶² The court rejected this argument: "While performance may be marginally helpful in evaluating the services which a fund offers, allegations of underperformance alone are insufficient to prove that an investment adviser's fees are excessive. . . . An under-achieving fund one year may be an overachieving fund the next."²⁶³ In the end, the court made clear that fund shareholders must allege "more than the mere recitation of boilerplate statutory language"; without factual allegations of the relationship between fees charged and services rendered, dismissal is required.²⁶⁴

²⁵⁹. Id.
²⁶⁰. Id.
²⁶¹. Id. at 326-28.
²⁶². Id. at 327.
²⁶³. Id. at 327-28.
²⁶⁴. Id. at 328. In Krantz v. Prudential Invs. Fund Mgmt., LLC, 305 F.3d 140, 143 (3d Cir. 2002), the United States Court of Appeals for the Third Circuit adopted the pleading standards articulated by the Fourth Circuit in Migdal. The court explained that for fund shareholders to plead (and prove) a breach of fiduciary duty, they must "examine the relationship between the fees charged and the services rendered by the investment advisor." Krantz, 305 F.3d at 143-44 (quoting Migdal v. Rowe Price-Fleming Int'l, Inc., 248 F.3d 321 (4th Cir. 2001)). Although the court did not recite the facts of the case, it held that the plaintiff had failed to allege any facts that demonstrated any disproportionality between services and fees; thus, dismissal was required. Id. at 144. The court noted that "this case is one of five virtually identical actions filed by Plaintiff's counsel in district courts in four
D. Yameen v. Eaton Vance Distributors, Inc.

In *Yameen v. Eaton Vance Distributors, Inc.*, the United States District Court for the District of Massachusetts asked whether an investment adviser had violated its fiduciary duty by authorizing and receiving distribution fees even when the mutual fund was closed to new investors. Even though the distribution and service fees were within the limits set by the National Association of Securities Dealers, fund shareholders contended that the fees became disproportionate, and thus excessive, when the fund closed to outside investors. Analyzing the Gartenberg factors, the court focused only on the independence and conscientiousness of the trustees. Fund shareholders alleged that the trustees failed to consider as a highly relevant factor the closing of the fund when they approved the fee plan. The court characterized “the crux” of the shareholders’ claims as being “that the fees [were] per se excessive because they exceed the de minimis ongoing sales expenses of a closed Fund.” Unpersuaded, the court explained that because the SEC had allowed mutual funds to compensate investment companies for past distribution services, the fees were not per se excessive. Moreover, the trustees had relied on counsel’s advice about the fees it charged. Aside from that, and probably most importantly, the court faulted the shareholders for failing “to 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.’” Again, a familiar refrain resounded that a fund shareholder had failed to provide information for the court to examine the relationship between the fees charged and services provided.

266. *Id.* at 351.
267. *Id.*
268. *Id.* at 355.
269. *Id.*
270. *Id.* at 357.
271. *Id.*
272. *Id.* at 356-57.
E. In re Dreyfus Mutual Funds Fee Litigation

In a rare departure from the norm of summary dismissal of fund shareholders’ claims, the United States District Court for the Western District of Pennsylvania concluded that the plaintiffs had adequately pled a breach of fiduciary duty claim under section 36(b). In the case of *In re Dreyfus Mutual Funds Fee Litigation*, the plaintiffs had claimed that their investment advisers had “breached their fiduciary duties by collecting fees in excess of standard charges, and in violation of SEC rules, and by failing to pass savings realized by economies of scale on to the investors.”274 Fund shareholders claimed that their investment advisers had participated in a form of “an undisclosed mutual fund kick-back scheme.”275 Specifically, fund shareholders alleged that their funds’ distributors and advisers used fund assets to encourage investors to buy shares of their mutual fund, which would concomitantly increase the fee calculated on the aggregate amount of money invested.276 In return, the advisers would pay large fees to the board of directors to gain approval of the kick-back schemes.277 The investment advisers defended with a common defense, i.e., fund shareholders had failed to demonstrate that the fees were “so disproportionately large that [they bore] no reasonable relationship to the services rendered.”278

Following the lead of many courts, this court cautioned that “[m]erely alleging that fees or costs were high or wrongful is not enough to satisfy the pleading requirements,” but rather the “definitive question 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.”279 In other words, the district court focused on the “relationship between the fees charged and the services rendered by the investment advisor.”280

Even though it concluded that fund shareholders had failed to adequately address the connection of the fees to the services rendered, the court nonetheless denied the advisers’ motion to dismiss.281 Addressing the contention that the investment advisers had failed to pass on economies of scale to the funds, the complaint was spared dismissal.282 The court pointed

275. *Id.* at 345.
276. *Id.*
277. *Id.*
278. *Id.* at 349.
279. *Id.* at 349-50.
280. *Id.* at 349.
281. *Id.* at 350.
282. *Id.*
out that Congress had contemplated an economies-of-scale claim when it recognized that the larger a mutual fund grew, the less expensive it was for advisers to provide additional services; Congress intended those savings to be passed to investors. Ultimately, however, the court entered judgment on the pleadings for the defendants because the plaintiffs had filed the suit as a class action rather than as a derivative suit.

F. Amron v. Morgan Stanley Investment Advisors, Inc.

Nearly a quarter century after Gartenberg, the Second Circuit addressed the Gartenberg standard and factors in Amron v. Morgan Stanley Investment Advisors, Inc. Attempting to track the Gartenberg factors in their complaints, fund shareholders sued their investment advisers. Even though the complaints tracked the factors, the court held that the complaints had failed to meet the Gartenberg standard: "nowhere does either complaint, 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 arm’s-length bargaining.’" The court analyzed the plaintiffs’ allegations under the Gartenberg factors. Regarding the nature and quality of the services provided, the plaintiffs merely alleged that their fund underperformed an index. As to the second and third Gartenberg factors, the plaintiffs complained that they could not obtain this evidence without discovery, but they proceeded to speculate about what evidence they might uncover. Although the plaintiffs provided some alleged evidence as to the fifth factor, the court noted that it was largely just "speculation, inference and generalized observations about the securities industry from public figures such as Warren Buffett."

The court did not bless such speculation and generalized information. The court deemed it fatal that fund shareholders had failed to allege the total amount of fees charged. Moreover, the court recognized that fund shareholders had utterly failed to allege the amount of operating costs or the

283. Id.
285. 464 F.3d 338 (2d Cir. 2006).
286. Id. at 341.
287. Id. at 342.
288. Id. at 341.
289. Id.
290. Id. at 343.
291. Id. at 344.
economies of scale.\textsuperscript{292} Because fund shareholders had failed to allege facts necessary to demonstrate the relationship between fees and the services, the Second Circuit affirmed the dismissal of the shareholders’ claims.\textsuperscript{293}

Ponder whether there are other areas of the law with a similar history to section 36(b) litigation. Can you name a legal standard that has endured for decades without being subject to an adjudicated illustration of how it actually—and not theoretically in a legalistic, unrealistic world—applies to actual cases with real people and real facts? The failure of any court to find in any case at any time that an investment adviser has breached its fiduciary duty with respect to the fees that it charged mutual fund shareholders has gone on for decades. It seems like the clear legal standard of Gartenberg, and now Jones, may never apply to an actual case. Could this streak last in perpetuity? So far, the streak of no adjudicated victories in section 36(b) cases goes on, day after day, month after month, year after year, decade after decade. Whether section 36(b) cases get dismissed at the pleadings\textsuperscript{294} or summary judgment stages,\textsuperscript{295}

\textsuperscript{292} Id. at 345.

\textsuperscript{293} Id. at 344.

after voluntary settlement,\(^296\) or even after a bench trial,\(^297\) one outcome is consistent—there is no reported case that illustrates when an investment


advisor has breached its fiduciary duty under section 36(b). Justice has not been—and cannot be—achieved under this phenomenon.

VI. SO WHAT IS A BREACH OF SECTION 36(b)'S FIDUCIARY DUTY?
I KNOW IT WHEN I SEE IT?

I have had the privilege to teach law students at Creighton University School of Law, Stetson University College of Law, the University of Nebraska College of Law, and Liberty University School of Law. As mentioned in the Introduction, I teach students that law is worthless without facts and that facts are worthless without law. Neither law nor facts exists in a vacuum; instead, each is wholly dependent upon the other. My students must not only state precise governing legal standards, they must also illustrate how those standards apply to real-world facts. Law is simply not meant to be studied in books and occupy one’s mind. Law is the application of collective values to real cases involving real people in real life. Why did I open this section with that pedagogical discussion? Because what is true for law students assuredly is true for attorneys and courts. Can you precisely state the legal standard that governs liability under section 36(b)? Of course you can quote section 36(b) and the Gartenberg-Jones standard. Can you precisely state the factors that analytically unlock the underlying legal standard? I know that you can list the Gartenberg-Jones factors precisely without difficulty. But now to prove whether your knowledge of the law exists in a vacuum void of facts, can you likewise describe adjudicated scenarios in which an investment adviser has violated its section 36(b) fiduciary duty? If not, then the legal standard is illusory at worst or theoretical at best. Without a collective understanding of the law’s application to actual cases, each person is left to a foggy understanding of what is just without the ability to predict what conduct is unlawful. Justice cannot be achieved under these conditions.

Is there no way to confidently conduct legal analysis to forecast a violation of section 36(b)? In Jacobellis v. State of Ohio, Justice Potter Stewart penned what might be the most famous line ever delivered from the Supreme Court. Without my giving it away, I suspect that many readers already have quoted Justice Stewart’s famous line. In Jacobellis, the Supreme Court


Court reversed the conviction of a defendant for possessing and exhibiting an obscene film in violation of state law.\textsuperscript{299} In essence, the Court concluded that because the film (and one scene, in particular) was not obscene, the First Amendment protected the defendant from prosecution.\textsuperscript{300} Admitting that obscenity cases might just involve "the task of trying to define what may be indefinable," Justice Stewart would have limited obscenity prosecutions to hard-core pornography.\textsuperscript{301} That was as far as Justice Stewart was willing to go, admitting that he did not attempt a further definition because "perhaps I could never succeed in intelligibly doing so."\textsuperscript{302} Justice Stewart then wrote the words that have followed his name for fifty years: "But I know it when I see it, and the motion picture involved in this case is not that."\textsuperscript{303}

When reading section 36(b) fee-litigation cases that interpret and apply the Gartenberg standard and factors, my mind quizzically asked if I know it when I see it. Indeed, this Article asks whether the law is capable of knowing a section 36(b) violation when it sees it. If not, then we each must individually apply our own I-know-it-when-I-see-it standard to illustrate when an investment adviser breaches its fiduciary duty under section 36(b). No person would ever wish to be judged under such an ill-defined, wholly subjective standard of liability. If there is no collective sense as to when a judicial standard applies to real people's conduct, then the judicial standard is unjust.

Perhaps the closest factual illustration of when an investment adviser breaches its fiduciary duty with respect to the receipt of compensation might be when the adviser extracts much greater fees from its captive retail funds than it can from its non-captive institutional clients. This evidence has been recognized as highly probative by the Eighth Circuit in \textit{Gallus}\textsuperscript{304} and Judge Posner's dissent in \textit{Jones}.\textsuperscript{305} The stark contrast in these situations reveals precisely what arm's-length bargaining can accomplish in terms of the fees that an investment adviser can charge. At oral argument before the Supreme Court in \textit{Jones}, the fund shareholders' attorney argued that "the best gauge of a fair fee is what the investment adviser charges at arm's-

\textsuperscript{299} Id. at 185-87.
\textsuperscript{300} Id. at 187, 190, 196.
\textsuperscript{301} Id. at 197 (Stewart, J., concurring).
\textsuperscript{302} Id.
\textsuperscript{303} Id. (emphasis added).
\textsuperscript{304} Gallus v. Ameriprise Fin., Inc., 675 F.3d 1173 (8th Cir. 2012).
\textsuperscript{305} Jones v. Harris Assocs., L.P., 537 F.3d 728, 731 (7th Cir. 2008) (Posner, J., dissenting).
length in other transactions for similar services” and, “applying that standard here, [the investment adviser] charged twice as much in percentage terms for providing virtually identical advisory services in arm’s-length transactions with institutional investors.”

Please allow me to provide an analogy that might best illustrate how probative this evidence can be. Interestingly, and perhaps ironically, the lead plaintiff in the Jones case is named Jerry Jones. Let’s call this Jerry Jones Middle Class Jones. To recap, Middle Class Jones’s main contention is that his fund’s investment adviser breached its fiduciary duty by charging captive retail investors twice as much as it charged institutional investors for similar advisory services. Middle Class Jones does not personally negotiate the fee that he will pay for the services provided to him; instead, his fund’s board of directors negotiated the fee. And the investment adviser created the fund, selected the board members, and provided the board with the information that the board used to retain the investment adviser and its fees. Being captive, the fund did not have the luxury to seek the services of another investment adviser. At the end of the “fee negotiations,” assume that the captive retail fund of which Middle Class Jones is a shareholder entrusted $2 billion to the investment adviser and paid a 1% fee.

Now assume that there is another Jerry Jones. Let’s call him Moneybags Jones and further assume that he happens to be the Jerry Jones who owns the Dallas Cowboys and stands as the 166th richest American with a net worth of $3 billion. Assume that Moneybags Jones also entrusted his money with the same investment adviser as Middle Class Jones. Instead of investing alongside Middle Class Jones in a captive retail mutual fund, however, Moneybags Jones approached multiple investment advisers to negotiate fees and services. Moneybags Jones engaged in tough, adversarial negotiations with investment advisers, who knew that he had every opportunity to walk away from the negotiations to entrust his funds to another adviser if Moneybags Jones did not like the fees-for-services offer. After hard-fought negotiations, Moneybags Jones agreed to entrust $2 billion to the investment adviser and paid a .5% fee.

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309. To make the point starker and more bitter, Moneybags Jones might even have the ability to only entrust $100 million to the investment adviser for the same .5% fee, and then get discounted fees as amounts under management exceed $100 million. This could only seem too-good-to-be-true to Middle Class Jones.
The question that screams out is what made Middle Class Jones pay twice the advisory fee than what Moneybags Jones paid for similar services. The answer that echoes in response is that Moneybags Jones had the protection of using the competitive free marketplace to its fullest advantage to engage in arm's-length bargaining over fees and services. Middle Class Jones and his captive mutual fund, on the other hand, did not enjoy arm's-length bargaining over fees, nor did they reap the rewards that come from free-market competition.\(^\text{310}\)

The disparate fees charged to Middle Class Jones's mutual fund versus those charged to Moneybags Jones's institutional account dramatically impacts performance. Assume that the investment adviser averages an 8% annual return for forty years for both Middle Class Jones and Moneybags Jones. Absorbing a 1% advisory fee, Middle Class Jones's mutual fund will be worth $29.1 billion, while Moneybags Jones will be worth $35.6 billion after paying half the advisory fee. Even though both accounts entrusted the same $2 billion with the same investment adviser, enjoyed the same returns, and received generally the same advisory services, the client with bargaining

\(^{310}\) I hold shares in two Dodge and Cox mutual funds, which treat me as a middle-class investor the same as they treat their moneybags investors. According to a recent article in Barron's, "Dodge & Cox funds are sold in the equivalent of frustration-free packaging. The funds have just one share class, and all investors, whether institutions or individuals with the $2,500 minimum, pay the same expense ratio, which ranges from 0.45% to 0.66% depending on the fund." Sarah Max, The Minimalists Next Door, BARRON'S (Jan. 12, 2015). I also have long-held shares in the Sequoia Fund, which also charges retail and institutional investors the same advisory fee. When asked if the investment adviser was "ever going to lower the 1% fee," the investment adviser's president responded, "Our asset base is about $8 billion and our cash is about $1.6 billion. We charge a flat 1% on both the separately managed portfolios and on Sequoia because they are treated the same. They get the same allocations; they buy the same stocks, et cetera. We have had that fee structure for decades and we hope to be able to continue to earn it." Ruane, Cunniff & Goldfarb Investor Day at 9, St. Regis Hotel, New York City (May 16, 2014), available at http://www.sequoiafund.com/Reports/Transcript14.htm (last visited Sept. 1, 2014). On a brief side note, when Warren Buffett liquidated his investment partnerships, he offered his partners three options: (1) leave the partnerships with cash; (2) accept Berkshire Hathaway stock; or (3) take shares in the Sequoia Fund, which was run by a legendary investor and contemporary of Buffett, Bill Ruane. Warren Buffett, Letter to the Partners, May 29, 1969, available at http://www.bengrahaminvesting.ca/Resources/links.htm (last visited Mar. 6, 2015); see ANDREW KILPATRICK, OF PERMANENT VALUE: THE STORY OF WARREN BUFFETT 57 (1994); Graham Summers, The Sequoia Fund, iSTOCK ANALYST (Aug. 14, 2008, 2:23 PM), http://www.istockanalyst.com/article/viewarticle/articleid/2513932.
power outpaced the client without bargaining power by $6.5 billion. Fees matter!

While I grew up, I often heard my factory-worker, union-dues-paying father say, "The rich get richer and the poor get poorer." I have never been fully persuaded by the accuracy of this oft-cited blue-collar perspective, but as the saying relates to fees for advisory services, it seems evident that the poor certainly do not enjoy the same benefits that the free market offers to the rich. In terms of the impact that fees have on wealth creation, there is no doubt that if the rich enjoy the free market's offer of unlimited and unrestrained bargaining power to negotiate lower fees while the poor or less wealthy, by contrast, have a limited and restrained opportunity to negotiate lower fees, the rich undoubtedly will pull away in growing their wealth over time for no other reason than the drag on performance that comes from higher fees.

311. I doubt that the impact that fees have on investment performance can be over-illustrated. To that end, here is a further demonstration of how fees impact the net returns of investors. This illustration, while similar to the Jones illustration, emphasizes the differences in wealth creation caused by disparate fees when funds are collectivized, i.e., a lot of Moneybags Jones are aggregated to compare them to a lot of Middle Class Jones who are aggregated. Because it has been approximately forty years since section 36(b)'s federally protected fiduciary duty was enacted, let's use that time period to illustrate anew the impact that fees have on investment returns. Assume that an investment adviser manages two $20 billion accounts, both accounts compound at 8% per year for forty years, and the adviser charges fees of .3% of Fund 1's assets and 1% of Fund 2's assets. At the end of forty years, Fund 1 will have paid fees totaling $15,418,657,900.22, and its net assets would be $385,288,944,574.28. Tragically, Fund 2 will have paid fees totaling a staggering $42,242,019,242.15, and its net assets would be $290,661,826,995.98, nearly $100 billion less than similarly situated Fund 1. Fees matter! To further highlight what is at stake, let's finally assume that the adviser manages two $100 billion accounts, each account compounds at 8% per year for forty years, and the adviser charges fees of .3% of Fund 1's assets and 1% of Fund 2's assets. At the end of forty years, Fund 1 will have paid fees totaling $77,093,289,501.08, and its net assets would be $1,926,444,722,871.38; Fund 2 will have paid fees totaling a breath-taking $211,210,096,210.74, and its net assets would be $1,453,309,134,979.91. The difference in net assets caused only by fees equals $473,135,587,891.47. That is nearly one-half trillion dollars. Only twenty-six nations enjoy gross domestic products that are larger. 2013 List of Gross Domestic Product by Nation, WORLD BANK (Dec. 16, 2014), http://databank.worldbank.org/data/download/GDP.pdf. Indeed, the excess fees collected in the last scenario are greater than the gross domestic product of well-established nations such as Austria, United Arab Emirates, South Africa, Denmark, and Israel. Fees matter!

312. A recent article on YAHOO FINANCE further illustrates this point. See Ronald Delegge, Portfolio Report Card: A $171,000 Retirement Portfolio Weighed Down by Cost, YAHOO FIN. (Aug. 6, 2014), http://finance.yahoo.com/news/portfolio-report-card-171-000-225223998.html. In this article, the author conducted a "Portfolio Report Card" for a 49 year-old U.S. Marine Corps Officer referred to as K.B. K.B.'s retirement plan consists of $171,946 invested in twelve mutual funds and two stocks. Id. K.B.'s largest holding is a
One of America’s wealthiest individuals, Warren Buffett, serves as the long-standing Chairman of the Board of Directors, President, and Chief Executive Officer of the highly successful Berkshire Hathaway. He often criticizes public policy (focusing mostly on taxation) that results in favoring the wealthy over less fortunate members of society; his criticism is often countered with criticism that he is playing class warfare with issues.

Addressing such criticism head-on, Buffett exclaims, “There’s class warfare, all right, but it’s my class, the rich class, that’s making war, and we’re winning.” If such a class-warfare debate focused on investment advisory fees, then I would tend to agree with Buffett on who is winning.

To counter the unnecessary result of the wealthy getting preferred treatment on fees, or at least the less wealthy getting taken to the cleaners by high fees, Buffett implores average retail investors to keep their investing costs low to maximize returns. Buffett has given crystal-clear investment instructions to the trustee who will control significant assets held in trust for the benefit of Buffett’s wife: “Put 10% of the cash in short-term government bonds and 90% in a very low-cost S&P 500 index fund. (I suggest Vanguard’s.) I believe the trust’s long-term results from this mutual fund with a .66% fee, while five of his mutual funds charge sales loads greater than 4% and annual fees greater than 1%. Id. The author gives his strong opinion that “[K.B.]’s getting taken to the cleaners on cost.” Id. The author estimates that K.B. will forfeit $17,000, or 10% of his current portfolio, if he keeps his money in the high-fee mutual funds. Id. In a huge understatement, the author concluded, “That’s a lot of money to be leaving on the table!” Id. I doubt that K.B.’s investment performance would be weighed down by fees as much if he were a billionaire with bargaining power on fees rather than a middle-class Marine.


315. Id.

316. Under the decades-long leadership of low-fee evangelist Jack Bogle, Vanguard Funds are doing extremely well these days as Americans pull their money from actively managed, high-fee funds to entrust with passively managed, low-fee funds. See Kirsten Grind, Investors Shun Stock Pickers: Index Funds Run by Vanguard See Record Inflows as Savers Turn to Autopilot, WALL ST. J., Jan. 5, 2015, at A1; Pauline Skypala, Vanguard Funds Prosper by Low Cost Evangelism, FIN. TIMES (July 14, 2014), http://www.ft.com/cms/s/0/c54941ce-0b22-11e4-a6b-00144feabad0.html#axzz3fiYbKwqC. Vanguard’s mutual funds have been described as unique in the mutual fund industry for being a mutually run group of funds owned by its funds’ investors. Id. One reporter characterized Vanguard as “a lone voice for many years evangelising the importance of low costs; and it makes good on that by offering some of the lowest cost index trackers and
policy will be superior to those attained by most investors—whether pension funds, institutions or individuals—who employ high-fee managers.” If this low-fee strategy is good enough for the estate of the greatest investor of all time, then it might be prudent for retail investors to consider it as well. If retail investors were to avoid high advisory fees, then section 36(b) would become mostly irrelevant.

Recent studies reveal that the wealthy are doing well relative to their fellow citizens and to historical norms. For example, the time period leading up to the stock market crash of 1929 exhibited massive differences in wealth among classes in America. At that time, the top 0.1% of Americans controlled 25% of the wealth, and the bottom 90% held just 16% of America’s wealth. By the time that Gartenberg rolled around in the early 1980s, on the other hand, the American middle class controlled 36% of household wealth versus 9% being controlled by the top 0.1%. Over the past three decades, the roles have once again reversed in a big way:

The 16,000 families making up the richest 0.01%, with an average net worth of $371 [million], now control 11.2% of total wealth—back to the 1916 share, which is the highest on record. Those

actively managed funds on the market.” Id. Similar to Buffett’s advice, Vanguard preaches low-cost, buy-and-hold investing focused on the long term. Id. As a mutually run group of funds, Vanguard’s average expense ratio of 0.19% strangles the industry average of 1.08%. Id.


319. Free Exchange, Forget the 1%, It is the 0.01% Who are Really Getting Ahead in America, ECONOMIST (Nov. 8, 2014), http://www.economist.com/node/21631129/print.

320. Id.
down the distribution have not done quite so well: the top 0.1% (consisting of 160,000 families worth $73 [million] on average) hold 22% of America’s wealth, just shy of the 1929 peak—and exactly the same share as the bottom 90% of the population. 321

Additionally, try to wrap your head around these statistics: the top .004% of the world’s adult population controls approximately 13% of the total global wealth; and at some point this year, the wealthiest 1% will hold 50% of the world’s wealth with the remaining 50% held by the remaining 99% of the world’s population, i.e., 1% will equal 99%!322

Although it may seem like I am on a tired socialist diatribe against American inequality (which inappropriately equates wealth and income, by the way), that is not my intent. Instead, I use these statistics only to illustrate how free-market, arm’s-length bargaining lowers investment advisory fees for the wealthy and how lower fees improve investment results in a big way over time. On the other hand, unfortunately, millions of less wealthy Americans do not enjoy the fee-lowering power of arm’s-length negotiations and competition. Over time, I contend, the fee disparity alone contributes massively to the amount of wealth enjoyed by the wealthy as opposed to the less wealthy. Ironically, perhaps, investment advisers are part of the wealthy class; they extract higher fees from the less wealthy class; the cycle continues! Section 36(b)’s fiduciary duty attempted to even the playing field somewhat by ensuring that captive retail investors had the same bargaining power on fees as to their collective trillions of dollars as enjoyed by non-captive investors with their trillions of dollars.

Even though fund shareholders do not prevail in court cases with adjudicated outcomes, some fund shareholders have garnered

321. Id.

322. Emily Jane Fox, The Ultra-Wealthy Get $2 Trillion Wealthier, CNN (Nov. 19, 2014), http://money.cnn.com/2014/11/19/luxury/ultra-wealthy-got-wealthier/index.html?sr=fbmoney111914wealth0345story; Faith Karimi, Wealthiest 1% Will Soon Own More Than the Rest of Us Combined, Oxfam Says, CNN (Jan. 19, 2015), http://www.cnn.com/2015/01/19/world/wealth-inequality/index.html. Robert Frank, a CNBC author, recently cited two academic papers to explain that wealth inequality can be attributed, in part, to “higher investment returns of the wealthy.” Robert Frank, It’s True, the Rich Do Get Richer—Here’s Why (Nov. 18, 2014), http://www.cnbc.com/id/102196033. Frank explained that the wealthiest 1% of Americans invest 75% of their savings, while middle-class Americans lock up 63% of their assets in their homes. Id. Additionally, the top 1% outpaced middle-class Americans by nearly 3% in investment returns over a four-year time period. Id.
Although settlements are fine for the parties involved, they cannot inform the boundaries of the law. Settled cases are not precedential; they have little predictive value on whether the law had been violated in a given case. But some settled cases leave little doubt that the law was violated.

Perhaps the most egregious illustration of a section 36(b) violation, albeit not an adjudicated one, can be found in the SEC’s 2012 lawsuit against an investment adviser. The SEC alleged that the investment adviser, for more than a decade, charged a mutual fund for services that it did not provide. Let me just repeat that fact for effect—an investment adviser charged advisory fees without providing a service! To settle the suit without admitting liability, the investment adviser agreed to not violate securities laws in the future, disgorge $1.3 million of its advisory fees, and pay a $250,000 penalty. To showcase its tough stance on excessive fees, the SEC also sued Morgan Stanley for its “shoddy oversight” of the outside Malaysian investment adviser. Morgan Stanley served as a sub-adviser to the mutual fund, and even though it provided no services, charged the fund’s shareholders $1.8 million. To settle the claims against it, Morgan Stanley agreed to repay the entire $1.8 million to the fund plus a $1.5 million penalty to the SEC for a total settlement of $3.3 million. A partner at Milbank Tweed Hadley & McCloy stated that this settlement is the first SEC enforcement action on mutual-fund fees in over three decades.

This settlement, with all of its fanfare, however, does not aid the interpretation and application of section 36(b)’s fiduciary duty or the Gartenberg-Jones standard. The reason is simple—it is elemental that the failure to provide any services in exchange for advisory fees per se results in fees that are so disproportionately large that they bear no reasonable relationship to the services rendered. What kind of rational investor would enter into arm’s-length bargaining with an investment adviser in which the

325. Id.
326. Id.
328. Id.
329. Id.
330. Id.
investor pays for non-existent advisory services? This ground-breaking case is nothing more than a fraud action. It does not aid a serious search for a disputed case in which section 36(b) has been violated or for an examination of the precise boundaries of the law in close, contested cases. I suspect that this egregious example of what took place in the multi-trillion dollar mutual fund industry is not an isolated case.

For over two decades, I have studied the investing principles practiced and espoused by two of my investing heroes, Warren Buffett and Charlie Munger.331 This Article has already referenced Buffett’s advice on low-cost investing. Munger probably is a lesser-known billionaire than Buffett, but he still holds a respectable rank on the Forbes list with a net worth of $1.3 billion.332 Munger has served as Buffett’s partner and vice chairman of Berkshire Hathaway, among many other ventures, for nearly four decades.333 Recently, Munger encapsulated his thoughts on what type of behavior often drives the money-management industry:

Back in 2000, venture-capital funds raised $100 billion and put it into Internet startups—$100 billion! They would have been better off taking at least $50 billion of it, putting it into bushel baskets and lighting it on fire with an acetylene torch. That’s the kind of madness you get with fee-driven investment management. Everyone wants to be an investment manager, raise the maximum amount of money, trade like mad with one another, and then just scrape the fees off the top. I know one guy, he’s


333. Id.
extremely smart and a very capable investor. I asked him, “What returns do you tell your institutional clients you will earn for them?” He said, “20%.” I couldn’t believe it, because he knows that’s impossible. But he said, “Charlie, if I gave them a lower number, they wouldn’t give me any money to invest!” The investment-management business is insane.334

I wonder if Munger, who graduated from Harvard Law School and founded the renowned law firm of Munger, Tolles & Olson, would characterize as “insane” the fact that no court has ever found that an investment adviser had breached its fiduciary duty under section 36(b). I contend that justice cannot be achieved as long as there is no adjudicated illustration of an investment adviser’s breach of its section 36(b) fiduciary duty.335 The next


335. Even though the Gartenberg-Jones standard can seem fatuous and airy when applied to real cases, two outposts are visible and helpful. First, the free market is not the sole regulator of compensation for investment advisers. Judge Easterbrook’s narrow reading of section 36(b)’s fiduciary duty gained no traction and is not the law. Second, the judiciary does not have the authority to engage in fee-setting, rate-making, or to determine the fairness of investment advisory fees generally. What is waiting, however, is a specific illustration in a disputed case of what a breach of section 36(b)’s fiduciary duty looks like. Although there is no such case currently, it would seem that certain fact patterns contend for the first-in-time victory. These fact patterns inevitably will showcase captive-like funds with little arm’s-length bargaining power under free-market conditions. To aid the discussion, please allow me to predict a few.

First, as Judge Posner and the Eighth Circuit intimated, the best indicator of what arm’s-length bargaining would produce is to compare what an investment adviser charges its institutional, non-fund clients against what it charges captive, fund clients. Although the investment adviser will always claim that the fees are disparate because the services performed are incomparable, this comparison seems to be the most fertile field for breaches of fiduciary duty. At some point, the law should begin to clarify the outer limits on the acceptable range of disparate fees for similarly situated clients, one with unfettered access to bargaining versus another with limited access to true, free-market bargaining. Along these lines, the absolute best comparator, however, might be in a case in which a mutual fund actually competed for investment advisory services, rather than simply “negotiating” with the adviser who holds it captive.

Second, fund shareholders should analyze whether the investment adviser has benefitted from economies of scale and whether the adviser has shared those with fund shareholders. Congress focused on this eventual Gartenberg factor, and fund shareholders should focus their efforts on this type of evidence. While doing so, however, it is prudent to
section explores Judeo-Christian principles that tend to support this contention.

VII. INVESTMENT ADVISERS' FIDUCIARY DUTY UNDER SECTION 36(B) AND EXCESSIVE FEE LITIGATION VIEWED THROUGH THE LENS OF A JUDEO-CHRISTIAN WORLDVIEW

As indicated in my biographical footnote above, the Editorial Board of the LIBERTY UNIVERSITY LAW REVIEW asked me to draft this Article exclusively for this Symposium Issue with its emphasis on the Christian Worldview of Financial Markets. For weeks, I pondered how to incorporate Judeo-Christian principles into my analysis of an investment adviser's fiduciary duty under section 36(b) and the last four decades of excessive-fee litigation to enforce that duty. I spent considerable time focusing on biblical principles and illustrations that address the concept of fiduciary duty generally. Section A sketches a brief outline of a few of those concepts. The focus of my Article, however, does not lie in generalized or abstract principles relating to fiduciary duty. I hope that you have realized by now that instead, the thrust of my Article maintains that simply articulating clear legal standards without the ability to apply them to real facts involving real people results in an illusory and unjust standard. To that end, I attempt in Section B to incorporate my thinking about Judeo-Christian principles and illustrations that reveal the dangers of having only a theoretical understanding of the law.336

keep in mind that the amount of fees charged will never exist in a vacuum; instead, the amount of fees must always be aligned to the services rendered. The overall focus in an economies-of-scale analysis, therefore, will be on the massive increase in fees while the overall services fail to increase at the same rate. Stated differently, if a well-informed investor with the ability to shop around aggressively negotiated with an investment adviser to receive various breakpoints for various asset levels, what would those breakpoints look like, and then compare those to what captive fund shareholders were given.

Third, it seems almost entirely irrelevant for an investment adviser to set its fees based on a comparison to what other advisers charge. The legal standard requires a focus on what arm’s-length bargaining would produce in a fees-for-service negotiation. It would be nice to see some type of decisional matrix that compares various fact patterns relating to fees charged and services rendered. At this point, we only know what is lawful; we do not know what is unlawful.

Finally, the recent SEC enforcement case against an investment adviser who charged significant fees while providing absolutely no advisory services probably will not repeat itself often. But there can be no easier case when analyzing a breach of fiduciary duty as to fees than this type of case involving run-of-the-mill fraud.

336. Because I absolutely believe that it is a worthwhile venture to ponder how Judeo-Christian values and principles impact what it means to serve as a fiduciary to others, I
A. Fiduciary Duty in the Judeo-Christian Tradition

The Judeo-Christian tradition is rich with teachings on the concept of fiduciary duty. Some scholars argue that the legal concept of fiduciary duty itself emanates from Judeo-Christian principles. The key principle that undergirds the Christian faith is embodied in Jesus’ teaching of the Golden Rule: “Therefore all things whatsoever ye would that men should do to you, do ye even so to them: for this is the law and the prophets.” You will note that all law hinges on a proper understanding and application of the Golden Rule. Jesus did not pluck this principle out of thin air two thousand years ago as part of His teaching ministry; instead, He enunciated a long-standing principle from the Old Testament: “thou shalt love thy neighbour as thyself.” The guiding light for any fiduciary of faith must be the Golden Rule.

In thinking about how best to illustrate the Golden Rule’s impact on how fiduciaries must act according to Judeo-Christian principles, I surveyed a number of biblical teachings. I will discuss a few of them in the text below. I also use extended footnotes to further share my thoughts that might guide your thinking should you choose to delve deeper into these concepts, principles, and illustrations.

The Parable of the Unjust Steward comes to mind as one of Jesus’ teachings that commands faithfulness when placed in a position of trust.

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included Section A’s general discussion in the Article. Section B, however, forms the core response to my analysis of section 36(b)’s fiduciary duty and, more directly, to the unappetizing four decades of litigation trying to enforce it on a theoretical basis only.


340. Luke 16:1-13 is the only Gospel that recorded the Parable of the Unjust Steward: And [Jesus] said also unto his disciples, There was a certain rich man, which had a steward; and the same was accused unto him that he had wasted his goods. And he called him, and said unto him, How is it that I hear this of thee? give an account of thy stewardship; for thou mayest be no longer steward. Then the steward said within himself, What shall I do? for my lord taketh away from me the stewardship: I cannot dig; to beg I am ashamed. I am resolved what to do, that, when I am put out of the stewardship, they may receive me into their houses. So he called every one of his lord’s debtors unto him, and said unto the first, How much owest thou unto my lord? And he said, An hundred measures of oil. And he said unto him, Take thy bill, and sit down quickly, and write fifty.
The principles that undergird the fiduciary duty readily can be seen as Jesus recites this memorable parable:

He that is faithful in that which is least is faithful also in much: and he that is unjust in the least is unjust also in much. If therefore ye have not been faithful in the unrighteous mammon, who will commit to your trust the true riches? And if ye have not been faithful in that which is another man’s, who shall give you that which is your own? No servant can serve two masters: for either he will hate the one, and love the other; or else he will hold to the one, and despise the other. Ye cannot serve God and mammon.

The clarity with which Jesus expounded on the Golden Rule in the Parable of the Unjust Steward is sharp and exacting. This parable forces a fiduciary to understand his duty of loyalty and to act in the interest of his beneficiary. It seems evident that Justice Cardozo’s exposition on the standard of care for a fiduciary borrows freely from the Parable of the Unjust Steward.

In addition to His vivid illustration of the Golden Rule in the Parable of the Unjust Steward, Jesus clearly and concisely expressed a fiduciary’s obligations when entrusted with another person’s property in the Parable of the Talents:

For the kingdom of heaven is as a man travelling into a far country, who called his own servants, and delivered unto them his goods. And unto one he gave five talents, to another two, and to another one; to every man according to his several ability; and straightway took his journey. Then he that had received the five talents went and traded with the same, and made them other five talents. And likewise he that had received two, he also gained other two. But he that had received one went and digged in the

Then said he to another, And how much owest thou? And he said, An hundred measures of wheat. And he said unto him, Take thy bill, and write fourscore. And the lord commended the unjust steward, because he had done wisely: for the children of this world are in their generation wiser than the children of light. And I say unto you, Make to yourselves friends of the mammon of unrighteousness; that, when ye fail, they may receive you into everlasting habitations. He that is faithful in that which is least is faithful also in much: and he that is unjust in the least is unjust also in much. If therefore ye have not been faithful in the unrighteous mammon, who will commit to your trust the true riches? And if ye have not been faithful in that which is another man’s, who shall give you that which is your own? No servant can serve two masters: for either he will hate the one, and love the other; or else he will hold to the one, and despise the other. Ye cannot serve God and mammon.
earth, and hid his lord’s money. After a long time the lord of those servants cometh, and reckoneth with them. And so he that had received five talents came and brought other five talents, saying, Lord, thou deliverest unto me five talents: behold, I have gained beside them five talents more. His lord said unto him, Well done, thou good and faithful servant: thou hast been faithful over a few things, I will make thee ruler over many things: enter thou into the joy of thy lord. He also that had received two talents came and said, Lord, thou deliverest unto me two talents: behold, I have gained two other talents beside them. His lord said unto him, Well done, good and faithful servant; thou hast been faithful over a few things, I will make thee ruler over many things: enter thou into the joy of thy lord. Then he which had received the one talent came and said, Lord, I knew thee that thou art an hard man, reaping where thou hast not sown, and gathering where thou hast not strawed: And I was afraid, and went and hid thy talent in the earth: lo, there thou hast that is thine. His lord answered and said unto him, Thou wicked and slothful servant, thou knewest that I reap where I sowed not, and gather where I have not strawed: Thou oughtest therefore to have put my money to the exchangers, and then at my coming I should have received mine own with usury. Take therefore the talent from him, and give it unto him which hath ten talents. For unto every one that hath shall be given, and he shall have abundance: but from him that hath not shall be taken away even that which he hath.  

Jesus commanded that a fiduciary must diligently and competently pursue without sloth or conflict the best interests of his principal. The Golden Rule could require nothing less. The Parable of the Talents ably demonstrates that not everyone has the same talents and should not be entrusted with precisely the same amount of responsibility. But to each fiduciary to whom property is entrusted, that fiduciary must ably and prudently manage, protect, and invest that property for the principal’s benefit. The better a fiduciary performs, the more responsibility the fiduciary can bear; on the contrary, the worse a fiduciary performs, the less responsibility—if any—the fiduciary can bear.

The lesson that the Parable of the Talents teaches in terms of section 36(b)’s fiduciary duty is that when an investment adviser provides outstanding services, the investment adviser should be rewarded with more

responsibility and pay. If I were to invert this principle and state it another way, however, I would conclude that the more that an investment adviser gets paid, the more services the adviser should provide. On the other hand, less responsibility and pay are in order for the investment adviser who offers poor services. Indeed, this lesson is a common theme that resounds in Jesus’ teachings: “For unto whomsoever much is given, of him shall be much required: and to whom men have committed much, of him they will ask the more.”  

The Parable of the Unjust Steward and the Parable of the Talents are prime illustrations that counsel the interpretation and application of section 36(b). Other Judeo-Christian principles also illustrate what it means to serve as a trusted fiduciary, and many of these enlightened my thinking about section 36(b). For example, I considered concepts and teachings such as Covenant theology, stewardship, the Jubilee, good faith and fair dealing, fraud and crooked dealing, usury and unwise debt practices,

343. See, e.g., Leviticus 25.
344. See 1 Corinthians 4:1-2 (“Let a man so account of us, as of the ministers of Christ, and stewards of the mysteries of God. Moreover it is required in stewards, that a man be found faithful.”); see also Leviticus 6:2-5 (“If a soul sin, and commit a trespass against the Lord, and lie unto his neighbour in that which was delivered him to keep, or in fellowship, or in a thing taken away by violence, or hath deceived his neighbour; Or have found that which was lost, and lieth concerning it, and sweareth falsely; in any of all these that a man doeth, sinning therein: Then it shall be, because he hath sinned, and is guilty, that he shall restore that which he took violently away, or the thing which he hath deceitfully gotten, or that which was delivered him to keep, or the lost thing which he found, Or all that about which he hath sworn falsely; he shall even restore it in the principal, and shall add the fifth part more thereto, and give it unto him to whom it appertaineth, in the day of his trespass offering.”).
347. See Deuteronomy 25:13-17 (“Thou shalt not have in thy bag divers weights, a great and a small. Thou shalt not have in thine house divers measures, a great and a small. But thou shalt have a perfect and just weight, a perfect and just measure shalt thou have: that thy days may be lengthened in the land which the Lord thy God giveth thee. For all that do such things, and all that do unrighteously, are an abomination unto the Lord thy God.”); Proverbs 11:1 (“A false balance is abomination to the Lord: but a just weight is his delight.”); Proverbs 11:3-6, 18-20, 23-28, 30-31 (“The integrity of the upright shall guide them: but the perverseness of transgressors shall destroy them. Riches profit not in the day of wrath: but righteousness delivereth from death. The righteousness of the perfect shall direct his way: but the wicked shall fall by his own wickedness. The righteousness of the upright shall deliver them: but transgressors shall be taken in their own naughtiness. . . . The wicked worketh a deceitful work: but to him that soweth righteousness shall be a sure reward. As righteousness tendeth to life: so he that pursueth evil pursueth it to his own death. They that are of a
and the Parable of the Workers in the Vineyard.\textsuperscript{349} There are countless biblical principles and illustrations of what it means to shoulder the heavy burden of a fiduciary duty, to be sure, but perhaps the prime examples of unbending, unyielding fiduciaries can be found in the lives of Jesus and Solomon.

In the Christian faith, Jesus was, is, and always will be the ultimate fiduciary in that He voluntarily became the substitute for the sins of all people.\textsuperscript{350} Indeed, who else can compare to a Man who proclaimed, "This is
my commandment, That ye love one another, as I have loved you. Greater love hath no man than this, that a man lay down his life for his friends."351
Not only did Jesus preach this type of unending love, He illustrated it as a fiduciary for others: "For God so loved the world, that he gave his only begotten Son, that whosoever believeth in him should not perish, but have everlasting life. For God sent not his Son into the world to condemn the world; but that the world through him might be saved."352

Myron T. Steele, a former Chief Justice of the Supreme Court of Delaware,353 published an article in the Notre Dame Journal of Legal Ethics and Public Policy in which he referred to Jesus as the "perfect fiduciary."354 Justice Steele explained that Jesus "was an utterly selfless steward sent to Earth to provide humanity the promise of eternal inheritance," "taught lessons in morality, including notions of loyalty and care toward others,"

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Christ after the flesh, yet now henceforth know we him no more. Therefore if any man be in Christ, he is a new creature: old things are passed away; behold, all things are become new. And all things are of God, who hath reconciled us to himself by Jesus Christ, and hath given to us the ministry of reconciliation; To wit, that God was in Christ, reconciling the world unto himself, not imputing their trespasses unto them; and hath committed unto us the word of reconciliation. Now then we are ambassadors for Christ, as though God did beseech you by us: we pray you in Christ's stead, be ye reconciled to God. For he hath made him to be sin for us, who knew no sin; that we might be made the righteousness of God in him."

Hebrews 10:10 ("By the which will we are sanctified through the offering of the body of Jesus Christ once for all."); 1 John 2:2 ("[H]e is the propitiation for our sins."); 1 Peter 3:18 ("For Christ also hath once suffered for sins, the just for the unjust, that he might bring us to God, being put to death in the flesh, but quickened by the Spirit."); Romans 6:23 ("For the wages of sin is death; but the gift of God is eternal life through Jesus Christ our Lord.").


352. John 3:16-17; see Isaiah 53:3-5 ("He is despised and rejected of men; a man of sorrows, and acquainted with grief: and we hid as it were our faces from him; he was despised, and we esteemed him not. Surely he hath borne our griefs, and carried our sorrows: yet we did esteem him stricken, smitten of God, and afflicted. But he was wounded for our transgressions, he was bruised for our iniquities: the chastisement of our peace was upon him; and with his stripes we are healed."). For a short article analyzing John 3:16 under traditional gift law principles, please see Tcy L. Lucas, The Greatest Gift, LIBERTY LEG. J. 24-27 (Spring 2014).


354. Myron T. Steele, The Moral Underpinnings of Delaware's Modern Corporate Fiduciary Duties, 26 NOTRE DAME J.L. ETHICS & PUB. POL’Y 5 (2012); see Szto, supra note 337, at 88 (citing Hebrews 3:1-6; Philippians 2:4; 1 Peter 1:3-5) ("In Christian theology, Christ is the perfect fiduciary. He is the selfless steward who lays down his life for others. By dying and rising, he enables those who accept him to have an eternal permanent inheritance. Christ is the bridge between death and life, time and eternity, temporal and permanent property.").
“embodied these morals about which He taught, and therefore served as an
example for mankind in the continued exercise of its fiduciary mandate to
steward the Earth in God’s likeness.” Justice Steele contends that although
“early theological examples were not legal precepts during biblical times, . . .
they nevertheless provide the starting point for the moral foundation of
modern corporate fiduciary duties.” Justice Steele explained, “Roman law
first tied these moral concepts to actual legal frameworks, which canon
lawyers later adopted in structures that eventually evolved into early trusts”; this led to “modern corporate fiduciary duties.”

I do not contend that Jesus is the legally enforceable example of how a
person satisfies his or her fiduciary duty. At least from the perspective of
trying to find the outer limits of how a fiduciary might treat his principal,
however, Jesus is hands-down the ultimate fiduciary in human history.
Although Jesus provides the perfect example of a selfless fiduciary, I am not
sure how to apply His life’s example to the interpretation and application of
section 36(b)’s fiduciary duty to investment advisers. But that does not
mean that it is altogether wrong for investment advisers to contemplate
their moral authority and opportunity to reflect upon Jesus’ life when living
their own. That rings true for all of us, at all times, in all that we do.

Another glowing example of how a fiduciary should strive to conduct
himself is found in King Solomon. Solomon was born into royalty as the
son of King David and Bathsheba, and the Bible declares that the Lord loved
Solomon. King Solomon “reigned in Jerusalem over all Israel [for] forty
years.” The part of Solomon’s story that intrigues me as it relates to the
concept of fiduciary duty can be found in Solomon’s approach to servant
leadership. As Solomon contemplated his enormous power and privilege,
he considered what he would want from God if he could only ask for it.
Carrying out his wishes as a steadfast and selfless fiduciary, Solomon
thought about others before he thought about himself:

In Gibeon the Lord appeared to Solomon in a dream by night:
and God said, Ask what I shall give thee. And Solomon said, . . .
And now, O Lord my God, thou hast made thy servant king
instead of David my father: and I am but a little child: I know not
how to go out or come in. And thy servant is in the midst of thy
people which thou hast chosen, a great people, that cannot be

355. Steele, supra note 354, at 5.
356. Id. at 6.
357. Id.
358. 2 Samuel 12:24.
359. 1 Kings 11:42.
numbered nor counted for multitude. Give therefore thy servant an understanding heart to judge thy people, that I may discern between good and bad: for who is able to judge this thy so great a people? And the speech pleased the Lord, that Solomon had asked this thing. And God said unto him, Because thou hast asked this thing, and hast not asked for thyself long life; neither hast asked riches for thyself, nor hast asked the life of thine enemies; but hast asked for thyself understanding to discern judgment; Behold, I have done according to thy words: lo, I have given thee a wise and an understanding heart; so that there was none like thee before thee, neither after thee shall any arise like unto thee. And I have also given thee that which thou hast not asked, both riches, and honour: so that there shall not be any among the kings like unto thee all thy days. And if thou wilt walk in my ways, to keep my statutes and my commandments, as thy father David did walk, then I will lengthen thy days.\textsuperscript{360}

Fiduciaries are held to the highest standards of prudence and loyalty. Solomon displayed unyielding loyalty to his people when he sought their interests before he sought his own. To some extent, section 36(b)’s fiduciary duty mandates that investment advisers act a little bit Solomonesque in dealing with their clients’ money. Amazingly, it is probably as true for an investment adviser as it is for Solomon that if an investment adviser puts away his own interest for a time and selflessly seeks his client’s best interests, then the adviser will benefit in huge ways the way that Solomon did.\textsuperscript{361}

I believe that every fiduciary, including investment advisers, would benefit from thinking about how to incorporate Judeo-Christian principles into their work. The task of incorporating these principles into the law’s interpretation and application of section 36(b)’s fiduciary duty is left for

\textsuperscript{360} 1 Kings 3:3-15 (emphasis added); see 1 Chronicles 28-29; 2 Chronicles 1-9; Psalm 72 (A Psalm for Solomon).

\textsuperscript{361} Solomon was human like the rest of us. He, too, struggled with being selfish rather than selfless as a fiduciary: “Did not Solomon king of Israel sin by these things? Yet among many nations was there no king like him, who was beloved of his God, and God made him king over all Israel: nevertheless even him did outlandish women cause to sin.” Nehemiah 13:26. The lesson from Solomon seems to be, however, that any person who serves selflessly as a fiduciary solely in the best interests of others will reap more rewards than a selfish fiduciary will enjoy. The Bible often teaches this seemingly counter-factual, counter-intuitive lesson of selflessness. See Matthew 16:25 (“For whosoever will save his life shall lose it: and whosoever will lose his life for my sake shall find it.”); Matthew 20:16 (“So the last shall be first, and the first last: for many be called, but few chosen.”).
another article, however. This Article contends that Judeo-Christian principles admonish the creation of mere theoretical legal standards to judge others. To the point, I contend that is precisely the unjust history of section 36(b) litigation. The next section expounds on this idea.

B. Is the Law on Our Side or Are We on the Law’s Side? Toward a Just Application of Section 36(b)’s Fiduciary Duty

Justice requires unbiased application of precise legal standards to real facts in real cases with real people to achieve consistent and predictable outcomes. Section 36(b) litigation lacks an adjudicated illustration of how an investment adviser breaches his fiduciary duty with respect to the receipt of compensation. Without an appreciation of what conduct violates the law, fund shareholders and investment advisers are left with interpreting the law with a bias tilted in their favor. Justice cannot be achieved when competing sides do not have an unbiased, arbitrated illustration of unlawful conduct. This section attempts to explore how Judeo-Christian principles caution against a mere theoretical understanding of the law. On the contrary, Judeo-Christian principles teach that justice is achieved when we are all subject to the same, precise governing legal standard that is consistently and fairly applied as intended.

The timeless allure of trying to place the law on our side rather than placing our conduct on the law’s side is strong. President Abraham Lincoln exposed this tension and temptation in stirring and convicting rhetoric. On Saturday, March 4, 1865, while the brutal and costly American Civil War was raging, President Lincoln delivered his Second Inaugural Address. Addressing his “Fellow-Countrymen,” which to him meant the entire Union—whether North or South, Slave or Free—President Lincoln declared:

Both [sides of the Civil War] read the same Bible and pray to the same God, and each invokes His aid against the other. It may seem strange that any men should dare to ask a just God’s assistance in wringing their bread from the sweat of other men’s faces, but let us judge not, that we be not judged. The prayers of both could not be answered. That of neither has been answered fully. The Almighty has His own purposes. “Woe unto the world because of offenses; for it must needs be that offenses come, but woe to that man by whom the offense cometh.” If we shall suppose that American slavery is one of those offenses which, in the Providence of God, must needs come, but which, having continued through His appointed time, He now wills to remove,
and that He gives to both North and South this terrible war as the woe due to those by whom the offense came, shall we discern therein any departure from those divine attributes which the believers in a living God always ascribe to Him? Fondly do we hope, fervently do we pray, that this mighty scourge of war may speedily pass away. Yet, if God wills that it continue until all the wealth piled by the bondsman’s two hundred and fifty years of unrequited toil shall be sunk, and until every drop of blood drawn with the lash shall be paid by another drawn with the sword, as was said three thousand years ago, so still it must be said “the judgments of the Lord are true and righteous altogether.”

With malice toward none, with charity for all, with firmness in the right as God gives us to see the right, let us strive on to finish the work we are in, to bind up the nation’s wounds, to care for him who shall have borne the battle and for his widow and his orphan, to do all which may achieve and cherish a just and lasting peace among ourselves and with all nations.362

This Judeo-Christian sentiment was one of President Lincoln’s core beliefs and part of his overall worldview. In a similar and consistent vein, one historian recounted of President Lincoln’s hearing a clergyman express his hope that “the Lord was on our side.” In rebuke, President Lincoln declared, “I am not at all concerned about that, for I know that the Lord is always on the side of the right. But it is my constant anxiety and prayer that I and this nation should be on the Lord’s side.”363

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363. F.B. Carpenter, Six Months at the White House with Abraham Lincoln: The Story of a Picture 282 (1867). When I taught at Creighton University School of Law, I attended a dinner with Justice Antonin Scalia. Justice Scalia told an amusing story about his perception of the difference between liberal and conservative justices. Justice Scalia remarked that his fidelity to the law emanates from his textualist approach to the interpretation and application of what the law says. Instead of trying to figure out what lawmakers intended, what is best for a society from a judge’s perspective, or how law should evolve, Justice Scalia said that he simply assumes that in making law, lawmakers say what they mean and mean what they say. In carrying out his textualist philosophy, however, Justice Scalia reported that he does not always like the result of his decisions. In many cases, his personal opinion of what the law should be or the ideal outcome of a case differs from his judicial conclusion. He explained that when he comes home from a hard day of judging, his wife, Maureen, often asks, “Nino, how was your day?” Justice Scalia often responds, “Well, dear, it happened again today. The law required a stupid result or one that I would not have chosen, but I had to interpret and apply the law as written and not as I would have written it.” When a liberal
President Lincoln accurately sums up my thinking as it relates to how to incorporate Judeo-Christian values and principles into American law and my analysis of section 36(b) litigation. There always will be a tension or temptation to use God to support our opinions or positions rather than forming our opinions or taking our positions in the first instance from God's standards. It seems commonplace for people to follow, knowingly or unknowingly, the clergymen’s statement in hoping that the Lord is on their side, rather than asking that they be on the Lord’s side. This counterproductive, self-fulfilling, selfish, and altogether-misguided temptation is particularly acute when we confront the task of judging each other—whether under God’s Law or Man’s Law—with a purported goal of justice, fairness, and equality. When confronted with any legal standard, its interpretation and application must be fairly and equally administered to be just. The standard cannot change depending on one’s vantage point; a fair result in one case must inevitably lead to the same result in a similar case. When it comes to an investment adviser’s charging fees for services provided to captive mutual funds, for example, justice demands that the interpretation and application of section 36(b)’s fiduciary duty standard must not change whether you are an investment adviser, mutual fund shareholder, or a court. One consistently interpreted and applied standard, fully applicable to all, leads to justice; any other path leads to injustice.  

Jesus often illustrated the importance of subjecting yourself to the same standards—legal or otherwise—to which you would subject others. His admonition to follow the Golden Rule rings as loudly today as when He uttered it, challenging us to do unto others as we would have others do unto us.  

In fact, Jesus proclaimed that every law hinges upon the Golden Rule:

justice comes home from a hard day of judging, Justice Scalia paints a portrait of a radically different conversation. When a liberal justice walks through the door at home and is greeted with the how-was-your-day question, the liberal responds, “Honey, can you believe that I am on an unbroken streak spanning 500 cases and fifteen years of judging where the outcome of the case is exactly what I personally want and the law just happens to support what I want every single time without fail!” Drawing an analogy between President Lincoln’s admonition and Justice Scalia’s story, it is almost as though the liberal justice declares, “Wow, I hope that the law is on my side, and believe it or not, it has been for a very long time!” At least, according to Justice Scalia, the conservative justice humbly asks, “I hope that I am on the law’s side.” Obviously, these are not exact quotes. Instead, I have approximated quotes based on my memory of what Justice Scalia said in order to share this amusing analogy with you. I am sure that some readers are not amused.

364. See Amos 5:24 (“But let judgment run down as waters, and righteousness as a mighty stream.”).

365. See Matthew 7:12 (“Therefore all things whatsoever ye would that men should do to you, do ye even so to them: for this is the law and the prophets.”).
Thou shalt love the Lord thy God with all thy heart, and with all thy soul, and with all thy mind. This is the first and great commandment. And the second is like unto it, Thou shalt love thy neighbour as thyself. On these two commandments hang all the law and the prophets.\(^{366}\)

In the story retold about President Lincoln above, if anyone should have known and understood God's law, surely it would have been the poor clergyman who was rebuked by President Lincoln. The clergyman did not show an appreciation for the Golden Rule and the two great commandments; instead, he sought an advantage in God's eyes. I can almost hear God's retort, which President Lincoln tracked, "Go back and learn Rules Number One and Two!"

Jesus spent significant time trying to get people to move out of their own way. The problem seems to lie in our constant desire to place ourselves at the center of everything. If everyone subscribed to that same worldview, however, then the net result would be that no one and no value would be at the center, if that makes sense. But it seems like human nature puts us front and center, while we tend to place our neighbor in the back corner. Even as Jesus exclaimed, "for I came not to judge the world, but to save the world,"\(^{367}\) many people choose to pick up the mantle of judgment. Whether using God's Law or Man's Law, it is a common temptation to judge others under a standard that is disparate from the standard under which we would judge ourselves. Jesus perhaps best illustrated this ageless temptation as follows:

Judge not, that ye be not judged. For with what judgment ye judge, ye shall be judged: and with what measure ye mete, it shall be measured to you again. And why beholdest thou the mote that is in thy brother's eye, but considerest not the beam that is in thine own eye? Or how wilt thou say to thy brother, Let me pull out the mote out of thine eye; and, behold, a beam is in thine own eye? Thou hypocrite, first cast out the beam out of thine own eye; and then shalt thou see clearly to cast out the mote out of thy brother's eye.\(^{368}\)

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366. Matthew 22:37-40 (emphasis added); Matthew 7:12.
368. Matthew 7:1-5 (emphasis added). Along those lines, Jesus spared a woman who had been convicted of adultery by posing a standards-based question of those who sought to judge her: "He that is without sin among you, let him first cast a stone at her." John 8:7. This quotation might be misplaced, but it illustrates that a consistently interpreted and applied standard under which we all can be judged leads to justice. Mercy is another topic. See Micah
The legal standard that implements section 36(b)'s fiduciary duty must be a standard under which we all can be judged equally, fairly, and transparently. To be just, the recitation and application of this standard cannot be based on self-interest, prejudice, bias, or point of view; it must be consistent and predictable. This predictability and transparency leads to self-regulating conduct instead of self-centered pursuit of a legal advantage. The thrust here is that the interpretation and application of a just and impartial standard requires that it apply equally to everyone. Without an effective, adjudicated illustration of when and how a standard is violated, however, then there essentially is no standard. Additionally, if one's interpretation and application of a standard somehow changes when that person's interest or vantage point changes, then it is clear that the person suffers from a biased and self-interested understanding of the law. This is a person who exemplifies the man who hopes that the Lord, i.e., the Law, is on his side, and not that he is on the Lord's, i.e., the Law's, side. In section 36(b) litigation, adjudicated illustrations of when an investment adviser breaches its fiduciary duty should be equally clear to all, regardless of whether one views the issue from an investment adviser's or fund shareholder's perspective. Because the timeless temptation to judge others under a different standard than that which we apply to ourselves is never going to dissipate, vivid illustrations of violations of section 36(b) are even more important.

In my experience, the failure of the law to clearly indicate what behavior falls outside the gambit of its governing legal standard results in three equally disastrous courses of behavior. First, lack of legal clarity leads to lawless behavior. Without a clearly interpreted and consistently applied governing standard that leads to predictable results, individuals will take liberties with their behavior. The Judeo-Christian worldview posits that these liberties will run nearly every time in favor of the individual and against another individual's interests. If everyone selfishly adhered to one's own individual standard, then there would be no governing legal standard. Unlike a person's selfish motives, the law is selfless and just. Second, the inability to predict the outcome of contested behaviors or factual scenarios causes conflict. The law's goal is not to create conflict; it tries to create a common set of societal values that resolve conflict. When the law fails to set a standard that effectively resolves actual disputes with real facts and real people, then parties with opposing views will constantly find themselves in conflict without the benefit of the law's powers of resolution. The

6:8 ("He hath shewed thee, O man, what is good; and what doth the Lord require of thee, but to do justly, and to love mercy, and to walk humbly with thy God?").
temptation will be to draw the lines of lawful conduct around one's behavior and against another's. That is, investment advisers and fund shareholders normally will not seek the application of the Golden Rule; instead, each will seek the law's favor. Third, a legal standard that fails to produce predictable penumbras of permissible behavior inevitably chills behavior. When plaintiffs cannot predict when a defendant's conduct is unlawful, this can lead plaintiffs to sue. Unguided by illustrations of unlawful conduct, these plaintiffs will not always seek a legal adjudication and a verdict, but often simply bring a strike suit in hopes of a settlement. Defendants, on the other hand, might sing the song of compliance with the governing legal standard, lip-synching behavior to the tune of legality. When defendants lack illustrative knowledge, unfortunately, then they have no guiding light to what conduct is actually—as opposed to theoretically—unlawful.

Even in the face of a clear and consistently interpreted legal standard, the law fails miserably when there are no judicial illustrations of what conduct violates that legal standard. When the law provides no clarity on what conduct is unlawful, it cannot inform a fund shareholder when to bring a section 36(b) claim or allow an investment adviser to operate within the outer limits of lawful behavior. As millions of fund shareholders and investment advisers interact daily with tens of trillions of dollars at stake, the law's failure to illustrate unlawful behavior creates uncertainty as to whose position on fees is lawful.

To illustrate my point, an investment adviser might breach its fiduciary duty even when it charges below-average fees. This could happen if that adviser provides below-average services and a shareholder can show that had arm's-length negotiations taken place between the fund and the adviser, the fund never would have made such a fees-for-services agreement. I do not promote a heads-I-win, tails-you-lose game stacked in favor of fund shareholders. For example, in cases in which an investment adviser provides industry-leading services, including returns on investment that trounce all peers, I would expect that actual, arm's-length negotiations between non-captive funds and the adviser likely would result in fees far exceeding industry standards. There is absolutely nothing wrong with high fees. The current state of the mutual-fund problem, however, is that neither fund shareholders nor investment advisers (not to mention courts and attorneys) can illustrate factually a judicially determined breach of an investment adviser's fiduciary duty. That means that the chilling effect of this opaque, cloudy area of the law actually might be forcing some investment advisers to accept lower fees, believe it or not, while many other investment advisers extract excessive fees while clinging to industry standards for justification.
Until the law can illustrate when an investment adviser’s fiduciary duty actually is violated under concrete facts, then the risk of lawlessness prevails.

My point is that quoting section 36(b) and the Gartenberg-Jones standards and factors is insufficient. Justice lies in action, not theory. The most profound biblical admonition that knowing a legal standard does not mean that you have a clue as to how that legal standard governs actual conduct is best illustrated by the Parable of the Good Samaritan. Jesus was confronted by an attorney asking how to inherit eternal life. Jesus responded, “What is written in the law?” Revealing his trained eagerness to please teachers and judges, the attorney answered with the precise governing standard, “Thou shalt love the Lord thy God with all thy heart, and with all thy soul, and with all thy strength, and with all thy mind; and thy neighbour as thyself.” Jesus confirmed that the attorney had correctly stated the law, showing at least head knowledge of the governing legal standard. Jesus then elevated the discussion by leaving the theoretical and academic realm by challenging the attorney on what it takes to actually comply with those standards or commandments. Jesus is not impressed by a person’s knowledge of the law, but by his ability to comply with its mandate. The attorney, on the other hand, had no ability to see how the law applied to real facts, so instead of applying the law, he chose to quibble over the legal definition of neighbor. At this point, Jesus provided seven sentences that clearly and unequivocally illustrated how the law applied to real facts involving real people:

A certain man went down from Jerusalem to Jericho, and fell among thieves, which stripped him of his raiment, and wounded him, and departed, leaving him half dead. And by chance there came down a certain priest that way: and when he saw him, he passed by on the other side. And likewise a Levite, when he was at the place, came and looked on him, and passed by on the other side. But a certain Samaritan, as he journeyed, came where he was: and when he saw him, he had compassion on him, And went to him, and bound up his wounds, pouring in oil and wine, and set him on his own beast, and brought him to an inn, and

took care of him. And on the morrow when he departed, he took out two pence, and gave them to the host, and said unto him, Take care of him; and whatsoever thou spendest more, when I come again, I will repay thee. Which now of these three, thinkest thou, was neighbour unto him that fell among the thieves? And he said, He that shewed mercy on him. Then said Jesus unto him, Go, and do thou likewise. \(^{375}\)

What does the Parable of the Good Samaritan have to do with section 36(b) litigation? The text of section 36(b)’s fiduciary duty is crystal clear, the Gartenberg-Jones standard can be concisely stated, and the Gartenberg-Jones factors are well-defined. Following Jesus’ approach to questioning the attorney in the Parable of the Good Samaritan, I likewise ask you—whether judge, attorney, academic, or student—if you can provide a clear and unequivocal illustration of when an investment adviser breaches its fiduciary duty with respect to the fees that it charges mutual funds. The law’s hesitant response screams injustice.

It is breathtaking to identify the people that Jesus used in the Parable of the Good Samaritan. I hope that it is not lost on you that it was an attorney who quizzed Jesus on the law. An attorney is trained to know the law and how to apply it. The attorney was used to demonstrate that knowledge of the law is worthless without a corresponding ability to apply it to real-world facts. The attorney recited the law; this is similar to how just about every court (with the rare exception of the Seventh Circuit) recites section 36(b), the Gartenberg-Jones standard, and the Gartenberg-Jones factors. Courts and attorneys might even possess analytical skills sharp enough to hone in on certain words within the law, seeking more lucid legal definitions, just as the attorney did with the term “neighbor.” But the attorney’s fatal flaw in the Parable was his inability, even in the face of knowing the text of the law, to understand when and how the law applied to real-world facts. That, too, is the fatal flaw in decades of section 36(b) litigation in adjudicating breach of fiduciary duty cases. That flaw leads to injustice.

It is equally breathtaking to realize that Jesus used a priest, a Levite, and a Samaritan to illustrate how the law actually applied to real people and real facts. It is convicting that Jesus chose to identify a priest and a Levite, among all alternatives, to illustrate that knowing and reciting the law is not even remotely close to knowing how to apply that law. In Jesus’ day, one could not describe two people more qualified to express and expound on

\(^{375}\) Luke 10:30-37. If only attorneys could communicate so clearly about the law and its application.
God's Law than a priest and a Levite. But even though they knew and could recite the law—and, God forbid, perhaps even controlled others' access to the law or judged others under that law—the priest and the Levite did not understand how to conduct their own lives to comply with the law. I contend that the entire legal profession can articulate the law that governs an investment adviser's fiduciary duty with respect to the receipt of compensation. Unfortunately, no member of the legal profession can profess to know, with any degree of certainty, how that law actually applies to contested cases with real people. There are no adjudicatory illustrations of an investment adviser's violation of section 36(b)'s fiduciary duty. As demonstrated by the priest and Levite in the Parable of the Good Samaritan, knowing the law and applying the law are two distinct attributes. Employing both skills is the path to justice.

Without belaboring my point, unless I have passed it, another example shows how simply knowing and reciting the law is insufficient. The SEC is the congressionally designated expert on the law governing capital markets and investment advisers. Congress provided the SEC with standing to enforce an investment adviser's section 36(b) fiduciary duty. If any organization could clearly state the governing legal standard and then identify factual scenarios that prove a violation of the law, surely the SEC fits the bill. Until recently, it had been over three decades since the SEC brought a section 36(b) claim against an investment adviser for breaching its fiduciary duty. One can deduce that the SEC had concluded that the mutual fund industry is entirely trustworthy or that the SEC cannot identify a violation of section 36(b). Even though the SEC knows the law, it apparently struggles to illustrate when that law is violated.

During oral arguments in Jones in 2010, the Solicitor General acknowledged that the SEC had not filed a section 36(b) lawsuit against an investment adviser in thirty years. To Justice Scalia, the SEC's failure to bring a section 36(b) suit combined with its focus on full disclosure of fee information suggested to him "that the SEC may think that this is indeed a self-contained industry and that the comparison with investment advice

376. See Numbers 18.


given to other entities [is] not a fair one." The Solicitor General responded that "when the SEC helped draft the statute in the 1960s, it recognized that there was this systematic disparity between the amounts that mutual funds were being charged by investment advisers and the amounts that investment advisers were charging their unaffiliated clients." Why has the SEC sat idly on the sidelines for so long?

Perhaps you are thinking along the lines as Justice Scalia that because Congress provided fund shareholders with a federal cause of action against investment advisers and that those shareholders have been exercising their rights to sue, there is no need to expend federal resources to have the SEC bring section 36(b) claims. That is, just let private attorneys general foot the bill to enforce federal law. That does not pass the smell test. It almost seems preposterous to imagine that Congress spent considerable energy to debate and pass a federally protected fiduciary duty, only to learn over four decades that no investment adviser would ever violate that duty and the SEC would be asleep at its post. Given the trillions of dollars in the mutual fund industry, it seems impossible to conclude that no investment adviser over a four-decade span ever overreached and violated its fiduciary duty with respect to fees in a disputed case.

Let me use an analogy to illustrate this point. Title VII of the Civil Rights Act of 1964 prohibits race discrimination, among other things; it was the culmination of a long and hard-fought battle. Title VII empowers both the Attorney General and private parties to enforce the federally protected right to be free from unlawful race discrimination. After centuries of barbaric slavery and segregation, imagine, if you will, if America had witnessed decade after decade of private parties' bringing and losing federal civil rights lawsuits under Title VII. I suspect that we as a nation would look to the Attorney General to then enter the fray to carry out public policy against unlawful and harmful discrimination. Despite its expertise in federal civil rights law, its obligation to enforce that law, and its understanding that no private plaintiff had ever proved a violation of Title VII, if the Attorney General continued to sit idle without attempting to enforce Title VII, we would be left with a couple of conclusions.

First, we could assume that the Attorney General believed that all is well in America and no person had ever experienced unlawful racial

380. Id. at 21.
381. Id. at 21-22.
discrimination after Title VII was passed. Even with a vast and troubling history filled with unspeakable racial injustice, apparently all that needed to happen was for Congress to pass a statute declaring that race discrimination was bad, and at that moment, all would be fixed, society would heal, and the sins of the fathers would vanish from our memories. If that were the case, we would expect the Attorney General to testify in Congress that either Title VII could be repealed because it is no longer needed, or that Title VII was working so swimmingly well that it should remain law. It would strain credulity, however, to think that after a long and hard-fought struggle to end the injustice of placing barriers to success based on the color of a person’s skin, that as soon as the law was enacted, all unlawful discrimination magically ended. That tracks my sentiment of not believing that after a long and hard-fought battle to legislate a federally protected fiduciary duty for mutual fund shareholders against investment advisers charging excessive fees, as soon as Congress passed section 36(b), like magic, not a single investment adviser dared to charge an excessive fee.

Second, we might, on the other hand, assume that the Attorney General believed that unlawful racial discrimination was still occurring, but for some reason, the Attorney General could not figure out how to enforce the law. Despite its knowledge of the law and its obligation to enforce it, the Attorney General could not illustrate a set of facts in a single case that proved racial discrimination. Justice would suffer if that had been the civil rights history of race discrimination litigation. Perhaps that is the state of affairs in section 36(b) litigation—the SEC simply cannot illustrate a set of facts in a disputed case that proves that an investment adviser breached its fiduciary duty with respect to the receipt of compensation.

It is mind-blowingly difficult to ponder that trillions of dollars belonging to hundreds of millions of people can be managed by thousands of firms with tens of thousands of employees over four decades without a single investment adviser being adjudged in a contested case to have violated its fiduciary duty with respect to the receipt of compensation. To pull this off and believe that section 36(b) has never been violated, one almost is required to suspend disbelief and enter an alternative reality.\footnote{384} Speaking of an alternative reality, in the Harry Potter series, Professor Sybill Patricia Trelawney was portrayed as an expert in divination at Hogwarts School of Witchcraft and Wizardry. She apparently possessed the gift of prophecy; she had been credited with prophesying that a good wizard would be born who would destroy the evil wizard, Lord Voldemort (tempting fate, I have named he-who-should-not-be-named). When Dolores Jane Umbridge became the ruthless Headmistress of Hogwarts, she openly taunted and belittled Professor Trelawney. In front of students, Headmistress Umbridge openly challenged Professor Trelawney to “predict something,” mocking her that she could not even
Justice requires that friend and foe be judged consistently under the same governing standard. Dr. Martin Luther King, Jr. vividly illustrated how the Golden Rule requires consistent action vice theoretical rhetoric. He preached that justice requires not just knowing the law, but consistently living it. On the day before he was assassinated at the young age of 39, Dr. King spoke in Memphis to support striking sanitation workers. His final speech on Earth focused, in part, on Jesus' Parable of the Good Samaritan and the urgent need for an actual and active—rather than theoretical—understanding of God's Law:

Be concerned about your brother [because] either we go up together, or we go down together. Let us develop a kind of dangerous unselﬁshness. One day a man came to Jesus, and he wanted to raise [a] question[] about some vital matters of life [such as what it means to love your neighbor as yourself]. . . . Now that question could have easily ended up in a philosophical and theological debate. But Jesus immediately . . . placed it on a dangerous curve between Jerusalem and Jericho. And he talked about a certain man, who fell among thieves. You remember that a Levite and a priest passed by on the other side. They didn't stop to help him. And finally a man of another race came by. He got down from his beast, decided not to be compassionate by proxy. But he got down with him, administered first aid, and helped the man in need. Jesus ended up saying, this was the good man, this was the great man, because he had the capacity to project the “I” into the “thou,” and to be concerned about his brother.

Now you know, we use our imagination a great deal to try to determine why the priest and the Levite didn't stop. . . . I'm going to tell you what my imagination tells me. It's possible that those men were afraid. You see, the Jericho road is a dangerous road. . . . It's a winding, meandering road. It's really conducive for ambush. You start out in Jerusalem, which is about . . . 1200 feet above sea level. And by the time you get down to Jericho, fifteen or twenty minutes later, you're about 2200 feet below sea level. That's a dangerous road. In the days of Jesus it came to be known as the “Bloody Pass.” And you know, it's
possible that the priest and the Levite looked over that man on the ground and wondered if the robbers were still around. Or it’s possible that they felt that the man on the ground was merely faking. And he was acting like he had been robbed and hurt, in order to seize them over there, lure them there for quick and easy seizure. And so the first question that the priest asked—the first question that the Levite asked was, “If I stop to help this man, what will happen to me?” But then the Good Samaritan came by. And he reversed the question: “If I do not stop to help this man, what will happen to him?” That’s the question before you tonight. Not, “If I stop to help the sanitation workers, what will happen to my job.” Not, “If I stop to help the sanitation workers what will happen to all of the hours that I usually spend in my office every day and every week as a pastor?” The question is not, “If I stop to help this man in need, what will happen to me?” The question is, “If I do not stop to help the sanitation workers, what will happen to them?” That’s the question. Let us rise up tonight with a greater readiness. Let us stand with a greater determination.

Dr. King’s timeless and inspiring words are a proper bookend to President Lincoln’s words that began this section. What is my point? Like moral obligations, the law does not exist in a theoretical realm. That is where injustice lies in wait, urging each one of us to reach separate legal conclusions on what the law authorizes, always drawing the line in our favor. This is the house of conflict. Justice calls us to a higher purpose; justice requires action. Justice requires the consistent and fair application of a precise governing legal standard to real facts with real people in real cases. When this happens, free people can order their lives under the transparent operation of just laws. And that is precisely what Judeo-Christian principles teach, as we have been reminded by Jesus, President Lincoln, and Dr. King. It is time for a court in a contested case to find a factual illustration that proves a breach of section 36(b)’s fiduciary duty. It is time that justice casts its sanitizing sunlight over the captive retail mutual fund industry.


VIII. CONCLUSION

With trillions of dollars of hard-working Americans hanging in the balance, it is vital that justice shines on the mutual fund industry. Section 36(b)’s fiduciary duty has regulated the collection of advisory fees by investment advisers for forty-five years without a clear vision in a contested case of when an investment adviser charges excessive fees. This judicial deficiency stands in stark contrast to the purpose behind section 36(b)’s enactment, namely, that the mutual fund industry endures structural conflicts of interest with captive fund shareholders having little or no ability to utilize free-market, arm’s-length bargaining to lower investment fees. Until a case illustrates a violation of section 36(b), justice will be impaired. And injustice will cascade upon injustice as high fees dampen investment returns over time.

Fund shareholders ultimately will claim their first judicial victory, but until then, we should recognize that when it comes to money, everyone will not play fairly, politely, ethically, or legally. A well-known biblical admonition cautions that “the love of money is the root of all evil.” Money seemingly draws crooks and criminals to its ambit. But when it comes to the federally protected fiduciary duty that protects millions of retail investors entrusting trillions of dollars to investment advisers from overpaying for investment advisory services, the mutual fund industry is apparently without sin. Most people reading this Article are shaking their heads in disbelief, exclaiming that this cannot be a four-decade reality. Regardless of collective disbelief, however, no court has found a violation of section 36(b)’s fiduciary duty in a contested case.

No matter how the law ultimately illustrates the outer limits of an investment adviser’s fiduciary duty on fees, it cannot happen soon enough.

387. 1 Timothy 6:10. Here is the quotation in full context: "But godliness with contentment is great gain. For we brought nothing into this world, and it is certain we can carry nothing out. And having food and raiment let us be therewith content. But they that will be rich fall into temptation and a snare, and into many foolish and hurtful lusts, which drown men in destruction and perdition. For the love of money is the root of all evil: which while some coveted after, they have erred from the faith, and pierced themselves through with many sorrows. But thou, O man of God, flee these things; and follow after righteousness, godliness, faith, love, patience, meekness." Id. at 6:6-11 (emphasis added). To illustrate how people behave badly when the love of money is at their core, let’s just play a little word association. When I provide you with a name, please make a mental note of what immediately comes to mind. Allen Stanford. Charles Ponzi. Raj Rajaratnam. Bernie Madoff. Ken Lay. Martha Stewart. I suspect that certain terms readily come to mind, such as money-grubbing, greedy, criminal, Ponzi (not surprising, particularly when in reference to Charles Ponzi), crooked, unethical, or words unfit for civil discourse generally or for inclusion in the Liberty University Law Review.
Justice requires a consistently and fairly applied standard to real cases. Even though the Gartenberg-Jones standard and factors are crystal clear, the lack of an adjudicated illustration of a violation of section 36(b) neuters the law such that there really is no standard. Injustice results when we judge people’s conduct without clear, enforceable, predictable standards. In a multi-trillion dollar industry ripe with conflicts of interest and lacking traditional markers of free market competition, it is vital that justice treats everyone—particularly captive fund shareholders—under a clearly articulated, consistently applied, easily illustrated standard. When that decision is announced, it will usher in a healthy dose of sanitizing sunlight.\(^{388}\)

\(^{388}\) To compound the nightmare that captive, passive retail investors experience when it comes to the drag on their investment returns from high fees, consider the case of Tibble v. Edison Int’l, 729 F.3d 1110 (9th Cir. 2013), that is currently pending before the Supreme Court. Tibble, 135 S. Ct. 43 (Oct. 2, 2014) (granting a writ of certiorari asking “[w]hether a claim that ERISA plan fiduciaries breached their duty of prudence by offering higher-cost retail-class mutual funds to plan participants, even though identical lower-cost institution-class mutual funds were available, is barred by 29 U.S.C. § 1113(1) when fiduciaries initially chose the higher-cost mutual funds as plan investments more than six years before the claim was filed.”). The basic thrust of the investors’ complaint is that pension plan fiduciaries breached their duty of prudence by choosing higher-fee retail funds when identical—but-cheaper institutional funds were equally available. Tibble, 729 F.3d at 1137. Oral arguments took place on February 24, 2015. Transcript of oral Argument, Tibble v. Edison Int’l, 135 S. Ct. 1193 (No. 13-550). Interestingly and notably, on February 23, 2015, i.e., the day before the Court held oral arguments in Tibble, President Barack H. Obama “directed the Department of Labor to move forward with a proposed rulemaking to protect families from bad retirement advice by requiring retirement advisers to abide by a ‘fiduciary’ standard—putting their clients’ best interest before their own profits.” WHITE HOUSE, OFFICE PRESS SECY, FACT SHEET: Middle Class Economics: Strengthening Retirement Security by Cracking Down on Backdoor Payments and Hidden Fees (Feb. 23, 2015), http://www.whitehouse.gov/the-press-office/2015/02/23/fact-sheet-middle-class-economics-strengthening-retirement-security-crac. To support a newly created fiduciary-duty standard for all retirement and investment advisers, President Obama made the following argument:

A system where Wall Street firms benefit from backdoor payments and hidden fees if they talk responsible Americans into buying bad retirement investments—with high costs and low returns—instead of recommending quality investments isn’t fair. These conflicts of interest are costing middle class families and individuals billions of dollars every year. On average, they result in annual losses of 1 percentage point for affected investors. To demonstrate how small differences can add up: A 1 percentage point lower return could reduce your savings by more than a quarter over 35 years. In other words, instead of a $10,000 retirement investment growing to more than $38,000 over that period after adjusting for inflation, it would be just over $27,500.  

\(\text{Id.}\) Does all of this sound familiar? No matter how all of these inflated-fee and conflict-of-interest issues ultimately will be resolved, one thing is certain—sunlight is indeed shining on the fees that investment advisers charge to millions of average Americans. Billions and billions of dollars hang in the balance.