IN THE SUPREME COURT OF THE UNITED STATES

- x

JERRY N. JONES, ET AL., :

Petitioners :

v. : No. 08-586

HARRIS ASSOCIATES L.P. :

- x

Washington, D.C.

Monday, November 2, 2009

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 10:04 a.m.

APPEARANCES:

DAVID C. FREDERICK, ESQ., Washington, D.C.; on behalf of the Petitioners.

CURTIS E. GANNON, ESQ., Assistant to the Solicitor General, Department of Justice, Washington, D.C.; on behalf of the United States, as amicus curiae, supporting the Petitioners.

JOHN D. DONOVAN, JR., ESQ., Boston, Mass.; on behalf of the Respondent.

C O N T E N T S

P R O C E E D I N G S

(10:04 a.m.)

CHIEF JUSTICE ROBERTS: We will hear argument first this morning in Case 08-586, Jones v. Harris Associates.

Mr. Frederick.

ORAL ARGUMENT OF DAVID C. FREDERICK

ON BEHALF OF THE PETITIONERS

MR. FREDERICK: Thank you, Mr. Chief Justice, and may it please the Court:

In 1970, Congress amended the Investment Company Act to provide a cause of action when an investment adviser breaches its fiduciary duty with respect to compensation.

The Seventh Circuit upheld summary judgment for Respondent under a legal standard for fiduciary duty that Respondent here no longer defends.

For three reasons, the Seventh Circuit's judgment should be reversed. First, under the Court's longstanding precedent, in this context a fiduciary duty requires a fair fee, achieved through full disclosure and good-faith negotiation.

Second, the best gauge of a fair fee is what the investment adviser charges at arm's-length in other transactions for similar services.

And, third, applying that standard here, Harris charged twice as much in percentage terms for providing virtually identical advisory services in arm's-length transactions with institutional investors.

With respect to the first point, the standard for fiduciary duty has been clear from this Court's cases, at least since Pepper v. Litton, in which the Court said that a fair result in the circumstances -- a fair fee -- was an important component of a fiduciary duty.

Congress was aware of that standard when it enacted the 1970 amendments to the Investment Company Act. The SEC brought the case to the Congress' attention, and that standard, we submit, is one that Congress intended to incorporate.

Applying that standard, where Pepper said that the best gauge of a fair fee is what the person -- the fiduciary charges in arm's-length transactions, applied here, the best way to understand how that fiduciary duty is being breached in this context is what Harris is charging for same or similar services at arm's-length to institutional investors.

JUSTICE KENNEDY: Is Harris 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?

I mean, the word "fiduciary" -- does fiduciary imply different standards, depending on what kind of fiduciary you are?

MR. FREDERICK: The basic concept, Justice Kennedy, is the same. There are two components, where there must be full disclosure of information and a fair result, and that fair result translates in different contexts in different ways. Here, because of the statutory references to fiduciary duty with respect to compensation, one focuses on the fairness of the fee charged.

But, as Professor Dumont points out in her amicus brief, the idea of a fiduciary duty is one that is well known in various circumstances of the law, and as applied here the concept goes to the fairness of the fee.

JUSTICE KENNEDY: Well, would the test for compensation in this case be the same as any director or any officer of a corporation?

MR. FREDERICK: The difference here, Justice Kennedy, is that in those circumstances the indicia of an arm's-length transaction may be achieved. The directors can fire the head of a company. They can call

for changes.

Here, the investment adviser has appointed the members of the board. As this Court said in the Daily Income Fund case, the earmarks of an -- of an arm's-length transaction are absent precisely because --

JUSTICE KENNEDY: I just want to know, is the fiduciary duties the same? Is the fiduciary standard the same, without getting into how its 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?

MR. FREDERICK: Yes. The concept is fair result through full information and good-faith negotiations.

JUSTICE SCALIA: And for lawyers?

MR. FREDERICK: For lawyers --

JUSTICE SCALIA: Lawyers have a fiduciary obligation to their clients; right?

MR. FREDERICK: That is true.

JUSTICE SCALIA: So courts should review lawyers' fees for -- on the basis of whether it's a fair result.

MR. FREDERICK: That is how courts do it every day in this country, Justice Scalia, when they are asked to make fee applications for reasonableness.

CHIEF JUSTICE ROBERTS: Well, but this is different. I mean, this is part of an expense of a fund. They don't get fees, but -- but they get -- they have to pay for the lawyers, just like they have to pay for management advice.

So why wouldn't you review the lawyers' fees to make sure they are fair?

MR. FREDERICK: The lawyers' fees in which context, Mr. Chief Justice? I'm not sure I understand the question.

CHIEF JUSTICE ROBERTS: Counsel for the fund.

MR. FREDERICK: Counsel for the fund is -- that is actually not at issue here, but the issue of what constitutes reasonable expenses may arise in various circumstances.

The statute prohibits fees that are unreasonable in terms of their unfairness to the fund. The concept here is that the board cannot fire the investment adviser. So in evaluating the fairness of the fee the adviser is charging the fund, the normal indicia of an arm's-length transaction is absent, and that is the key principle here because this adviser is using the same manager to provide the same research analytics from the same research group, from the same

meetings, buying the same stocks, and simply allocating them to different accounts and charging those to whom it owes a fiduciary duty twice what it is getting at arm's-length.

JUSTICE GINSBURG: 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.

MR. FREDERICK: And, Justice Ginsburg, that is where there is a disputed issue of fact for which summary judgment is not appropriate, because the plaintiffs submitted evidence that in fact the services provided to the institutional investors were greater, even though they were being charged a lower amount of money.

JUSTICE GINSBURG: Who would have the burden? You said that is an issue that has not been decided, it's a disputed issue of fact, appropriate for remand. Who -- would you have the burden if they came forward and said, look, this is what our situation is. These are the services. Would you have the burden to show that in fact they were comparable and the

differences did not warrant the differences in the fee?

MR. FREDERICK: Yes.

JUSTICE GINSBURG: You would have the burden?

MR. FREDERICK: We have the burden.

JUSTICE SCALIA: That's different from normal trust law, isn't it?

MR. FREDERICK: It is.

JUSTICE SCALIA: Normally where you are a fiduciary, it's up to you to prove that it was reasonable.

MR. FREDERICK: That's true.

JUSTICE SCALIA: So Congress evidently did not mean ordinary trust law to apply in this context.

MR. FREDERICK: We disagree with that last part, Justice Scalia. We agree that Congress did make modifications to the way a cause of action ordinarily would have been brought at common law for breach of fiduciary duty in several respects, including imposing the burden of proof on the investor. Where we disagree is that when they used the phrase "fiduciary duty" they intended to mean something less than what fiduciary duty had meant at common law.

CHIEF JUSTICE ROBERTS: What if -- if you are having courts decide -- review what is fair, a fair

fee, what if the adviser had given such good advice that the fund beat the industry average for his category of fund by 5 percent over the last 5 years. Does he get double the normal compensation of the average fees? Does he get triple? 50 percent more? How is the court supposed to decide that?

MR. FREDERICK: Well, there is an issue of fact as to how relevant performance is. They didn't give the money back when their performance lagged behind the market, Mr. Chief Justice, in this case. So the question of whether or not a performance metric is relevant is certainly a factor that will be entitled to less --

CHIEF JUSTICE ROBERTS: Well, surely you think it is. When you say they don't give the money back, you are not suggesting that the amount of the fees should be the same regardless of whether they outperform by 10 percent or not?

MR. FREDERICK: My point, Mr. Chief Justice, is that when they charge the same amount, buying the same stocks, to institutional investors and achieve the same performance, there is no reason why the mutual fund should be charged twice as much.

CHIEF JUSTICE ROBERTS: Well, but there is different parameters, right, in the sense that you're

trying -- the company is trying to attract investors to the mutual fund. If you are advising a pension fund, it is not the case that they are trying to attract pensioners who have other choices.

MR. FREDERICK: But the investor doesn't gain because of the marketing skill of the adviser. Simply having a larger asset pool which increases the fee that the adviser can charge doesn't inure to the individual benefit of the investor. And the point of this statute was to provide protection against investors so that when the adviser charged excessive fees that excess would be returned to the fund for the pro rata benefit --

JUSTICE KENNEDY: You said that Congress used "fiduciary" in a special sense. Then -- 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.

MR. FREDERICK: Well, Justice Kennedy, let me just add the extra words of the statute, because what Congress said was a fiduciary duty "with respect to compensation." And so when I say special sense, I mean

that Congress used additional words to elaborate on the circumstance in which the fiduciary duty would be examined.

Here what is happening is that an arm's-length transaction for the same services -- the same manager is going out and touting his services to the institutional investor, but simply charging them half as much money for providing the same portfolio of management.

CHIEF JUSTICE ROBERTS: Do technological changes make a difference in terms of disclosures required? These days all you have to do is push a button and you find out exactly what the management fees are. I mean, you just look it up on Morningstar and it's right there and you can make -- as an investor you can make whatever determination you'd like, including to take your money out.

MR. FREDERICK: The fact that an investor may know going in what the fee is does not address the problem Congress was intending to address, which is that as larger and larger sums of assets were accreted to the mutual fund, the investor was not obtaining the benefits of economies of scale. And that's the central point --

CHIEF JUSTICE ROBERTS: So we could look at -- you know, as the fund grows bigger and he doesn't

get those benefits he can go look at another fund. It takes 30 seconds.

MR. FREDERICK: And that again doesn't address the problem Congress was trying to get at, which is to protect the company, not the individual investor. The individual investor might lessen the damages that that investor suffers, but the fund, the people remaining, continue to pay excessive fees.

JUSTICE SCALIA: No, but he protects the company ultimately, because when investors leave the company that is charging excessive fees to go to other companies, the company that they are leaving sees that something's wrong and has to lower its compensation to its adviser. Why doesn't that affect the company at issue?

MR. FREDERICK: A large number of assets under management in mutual funds, something like 26 to 35 percent according to materials that are in the record, are from 401(k) plans, where the investor is essentially locked into the fund that his or her company chooses to make that investment. And even as to investors who are not locked in, there are significant tax consequences where over time an investor might be in the Oakmark Fund and have to suffer large tax consequences in order to get the benefit of the

statute --

CHIEF JUSTICE ROBERTS: Companies -- companies change who they invest with under the 401(k)'s all the time. The employees are not happy with the return they are getting because the company has limited their choices, they change. It happens all the time.

MR. FREDERICK: And Mr. Chief Justice, as the Court recognized in the Daily Income Fund case, this is a unique cause of action in which Congress was intending to protect the entire corpus of the investors in the fund, because --

CHIEF JUSTICE ROBERTS: You told me just a little while ago, or told somebody, Congress wasn't interested in protecting investors; they were interested in protecting the companies.

MR. FREDERICK: The company is comprised of the investors, Mr. Chief Justice. What the right of action does not do is to provide individual damages to the investor who brings the suit. The recovery inures to the entire benefit of all the investors.

JUSTICE SOTOMAYOR: Counsel, can I unpackage your argument a little bit. Because using the word "fair fee" in my mind is meaningless, because it has to be fair in relationship to something. And so what is your definition of what that something is that it's fair

to, and -- or unfair against? And start from there, because I understood the Seventh Circuit to be saying: Look, a fair fee is paying market value. If one takes a sort of reading -- whatever negotiation goes on between the two, as long as there has been full disclosure as required, that's the market. So that's fair. You're saying it's something else. What's that something else?

MR. FREDERICK: Well, what the Court said in pepper is that fair is what is reflective of what an arm's-length agreement would produce.

JUSTICE SOTOMAYOR: All right. So you start there.

MR. FREDERICK: Yes.

JUSTICE SOTOMAYOR: All right. So let's stop confusing this -- the articulation of the standard, which is -- that's fair. What would an arm's-length transaction produce? And let's go to what seems to be part of your argument and sort of what everyone's skirting around, which is what's the proof that a particular transaction is not arm's-length?

The Seventh Circuit appeared to be saying, it's arm's-length when the parties have done all of the disclosure that is required, because then the buyer can decide whether they want to pay that fee or not, and once they choose to it's a fair price. It's an arm's-

length transaction. You are saying not, and that's what -- that's where I am trying to get to the nub of why not? Why is --

MR. FREDERICK: Because the directors can't fire and walk away from the advisor. In any arm's-length transaction, if I sell you a car and you don't like the price can you walk away.

JUSTICE SOTOMAYOR: That's -- now, that's begging the question, because Congress hasn't said a reasonable fee. It did say fiduciary duty, but it didn't -- there is a subtle but very important difference between reasonable and -- a reasonable fee and a fiduciary duty with respect to fees.

MR. FREDERICK: True. There are two components: Was there full information and good faith negotiating; and was the result fair. In Pepper, the Court said if the result is not fair there can be a breach of fiduciary duty.

JUSTICE SOTOMAYOR: I'm still begging the question, fair against what.

MR. FREDERICK: Fair against what the adviser actually charged for same or similar services to an outsider who had the right to walk away.

JUSTICE SCALIA: Mr. Frederick, I don't understand your statement that they can't fire the

investment adviser. Maybe they can't fire him, but they can insist that he accept a lower fee, right? Surely they can do that, can't they?

MR. FREDERICK: They --

JUSTICE SCALIA: Can they insist that he accept a lower fee? Can they do that.

MR. FREDERICK: In practical terms, no.

JUSTICE SCALIA: Why?

MR. FREDERICK: Because the adviser picks the board of directors.

JUSTICE SCALIA: Oh, no, that's something different. Let's assume you have a disinterested board of directors, which is what the statute requires. You tell me even though they are disinterested, they can't fire the adviser. It seems to me, while they can't fire him, they can say: We are going to cut your fee in half. Whereupon they don't have to fire him. He will pack up and leave, and they will get a new adviser. Doesn't that work?

MR. FREDERICK: There is actually no evidence in any record I am aware of where that has actually happened. The directors have no leverage. And that's the problem the Court -- this Court recognized in the Daily Income Fund case.

If I could reserve the balance of my time,

please.

CHIEF JUSTICE ROBERTS: Thank you, counsel.

Mr. Gannon.

ORAL ARGUMENT OF CURTIS E. GANNON

ON BEHALF OF THE UNITED STATES,

AS AMICUS CURIAE,

SUPPORTING THE PETITIONERS

MR. GANNON: Mr. Chief Justice, and may it please the Court:

The fiduciary duty imposed by section 36(b) prohibits an investment adviser's fee from being outside the range that arm's-length bargaining would produce. The courts below erred by failing to consider evidence about what the investment adviser in this case charges its unaffiliated clients when it provides services that Petitioners claim are, in fact, comparable to the services at issue here.

JUSTICE KENNEDY: 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.

MR. GANNON: Well, we do think that --

JUSTICE KENNEDY: But it seems to me an odd use of the term "fiduciary." I don't know why Congress didn't use some other word.

MR. GANNON: Well, we do think that the term "fiduciary duty" is here used to counterbalance the lack of arm's-length bargaining that exists between the board of directors and the investment adviser, and we do think that it drew upon the established term of art in Pepper v. Litton, the case that counsel for Petitioners was already referring to. That's a case that actually involved corporate directors and there the same test, the same ultimate standard, was stated, which is whether the bargain carries the earmarks of an arm's length bargain and whether it's inherently fair.

And so we do think that in the development of the legislation in 1969, the memorandum that the SEC submitted to Congress in 1969 explained that the shift from reasonableness to fiduciary duty largely achieved some procedural objectives of shifting the focus from the board of directors to the investment adviser, and

the text of the statute specifically makes it a fiduciary duty with respect to receipt of compensation.

We think one salutary affect of that was to -- to make it clear that the Court's burden here, the Court's duty here, wasn't just to establish what the single most reasonable fee would be, but harking back to the Pepper v. Litton test, whether the bargain fell within the range of what arm's length bargaining otherwise would have achieved.

CHIEF JUSTICE ROBERTS: Counsel, if we are going to have regulation of what fees can be charged, you cite in your brief the various regulations the SEC has issued. It makes a lot more sense to have the SEC regulate rates than to have courts do it, doesn't it?

MR. GANNON: Well, in the abstract, it might make more sense, Mr. Chief Justice. I think the choice that Congress made here was to counterbalance the --

CHIEF JUSTICE ROBERTS: You are not suggesting the SEC wouldn't have authority to do that, are you?

MR. GANNON: Well, even under this statute, the SEC has the authority to file suits under section 36(b).

JUSTICE GINSBURG: Has it filed any?

MR. GANNON: It hasn't filed any since --

since 1980, Justice Ginsburg. I think that the SEC in this context -- it has -- it has primarily directed its resources and energies into encouraging there to be better disclosure of fees, both the disclosure of information to the board, disclosure to investors, better education to shareholders so that they would be able to go --

JUSTICE SCALIA: Well, it must be aware of the -- of the divergence between the fees that investment advisers charge to these companies and what they charge to other clients. Isn't the SEC aware of that?

MR. GANNON: It is aware of that.

JUSTICE SCALIA: And yet has brought no suits against this industry?

MR. GANNON: Since 1980 it hasn't used section 36(b). It has used less formal mechanisms in the context of examinations and investigators -- -

JUSTICE SCALIA: For disclosure, just for disclosure. But that suggests to me that the SEC may think that this is indeed a self-contained industry and that the comparison with investment advice given to other entities is -- is not a fair one.

MR. GANNON: Well, 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, and in the 1969 memorandum that I referred to, which is reprinted in an appendix to the amicus brief by John Bogel in its entirety, the SEC mentioned that comparison as being something that may well be relevant in proving in an individual case that that particular investment adviser's fees are excessive.

And we think that the test here of whether under all the circumstances, which is what section 36(b)(2) points the Court towards, of having to weigh -- having to weigh the board's approval of fees in light of all the circumstances, that those circumstances include things like the evidence that petitioners have presented here.

JUSTICE GINSBURG: Mr. Gannon, the -- all the circumstances, that comes from the Second Circuit's Gartenberg case?

MR. GANNON: Well, it also comes, Justice Ginsburg, from the text of section 36(b)(2).

JUSTICE GINSBURG: But in -- in that case, at least there was a footnote that seemed to say, you don't have to engage in a -- in the comparison with what institutional investors are paid.

MR. GANNON: The footnote that you are talking about did point out that in that case the comparison that the plaintiffs were attempting to draw between the money market fund at issue and a pension fund wasn't a particularly relevant one, because the services at issue were so different. And here the parties appear to dispute how different the services are. And at the summary judgment stage, the Respondent stated that it disputed how comparable the relevant services were.

The district court and the court of appeals considered that dispute immaterial because, instead of comparing, instead of determining whether this investment adviser is selling the same services at half the price to its unaffiliated clients who actually can engage in arm's length bargaining, those courts simply said that if it -- if it falls within the range that is charged by other mutual funds, that would be acceptable. And we --

CHIEF JUSTICE ROBERTS: Counsel, the statute does not say, in considering the rates you look at all the circumstances. Am I right? It says, in considering whether to defer to the board, you look at all the circumstances.

MR. GANNON: It does say that you should

give the board --

CHIEF JUSTICE ROBERTS: The board.

MR. GANNON: -- such consideration as is deemed appropriate under all the circumstances. That's correct.

CHIEF JUSTICE ROBERTS: Right. But isn't that different than saying, in looking at what the rates should be or whether they are excessive, you look at all the circumstances? It may well be that you don't defer to the board, but that doesn't mean it's a free-for-all in deciding what you do look at.

MR. GANNON: Well, I think that it demonstrates that the Court is obligated to look to all the circumstances simply to determine whether the board's approval -- how much weight it should be given.

And as this Court explained in Daily Income Fund, the entire point of section 36(b) is to provide an independent check, the -- independent of the fact that the directors approved the fees. We think that an appropriately informed board that asks the right questions, that gets the right information and fully considers the sort of factors that are discussed --

JUSTICE SOTOMAYOR: Even if they agree to pay double the price?

MR. GANNON: We think that -- that the right

process followed by the board would be probative, but something like double the price may -- may demonstrate that that is an unfair bargain.

JUSTICE SOTOMAYOR: That -- that's what -- are you advocating that there is a stand-alone cause of action or breach of duty when there isn't full disclosure, even if the fee is within arm's length -- normal -- begging the question of what's normal, but assuming that it's within an arm's-length transaction range in the market?

MR. GANNON: If there was a lack of full disclosure, that might in the abstract be a breach of fiduciary duty even under the Seventh Circuit's test. We think that if it didn't actually have an effect on the fees, then it wouldn't be actionable here because there would be no actual damages flowing from the lack of disclosure.

JUSTICE SCALIA: But even if there is full disclosure, your position is in every case a court must decide whether the fee is reasonable or not.

MR. GANNON: A court would need to decide whether the plaintiff has met its burden of proving that it falls outside the range of fees that arm's-length bargaining would have arrived at, and that's a cause of action that would be --

JUSTICE SOTOMAYOR: Well, how much deviance, and what is the scope of the range?

MR. GANNON: Well, 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.

JUSTICE KENNEDY: How is the -- how is the standard you've just described different from a standard of reasonableness?

MR. GANNON: It -- I think that the chief way it differs from reasonableness, Justice Kennedy, is in saying that the Court doesn't actually have to decide what the single most reasonable fee is. But as the SEC explained in 1969, the shift from reasonableness to --

JUSTICE KENNEDY: Well, I would be very surprised if "reasonableness" always meant one -- one figure. It could mean a range.

MR. GANNON: Well, I think reasonableness is - is inevitably going to be part of the inherent

fairness inquiry that this Court referred to in Pepper v. Litton as being part of the fiduciary duty status as to whether the transaction --

JUSTICE STEVENS: May I ask you a question going back to Justice Kennedy's early question? Do you think the fiduciary status of the defendant in this case is different from the fiduciary status of a president of a corporation?

MR. GANNON: I -- I -- I think that it is different from the status of a president of a corporation; that -- that the term of art, "fiduciary" which Congress was invoking here can mean different things in different circumstances.

Pepper was a case that involved corporate directors. The chief difference here and what Congress was intending to counteract was the inherent structural impediment to arm's-length bargaining between the investment adviser and the board of directors. And that's what makes that high burden that was used in Pepper v. Litton for controlling shareholders the relevant analogy, we believe.

CHIEF JUSTICE ROBERTS: Thank you, counsel.

MR. GANNON: Thank you, Mr. Chief Justice.

CHIEF JUSTICE ROBERTS: Mr. Donovan.

ORAL ARGUMENT OF JOHN D. DONOVAN, JR.

ON BEHALF OF THE RESPONDENT

MR. DONOVAN: Mr. Chief Justice, and may it please the Court:

The point that Mr. Gannon just made and that Mr. Frederick made before, that there was some structural impediment to negotiations between a mutual fund board and adviser, is at the heart of this dispute, because that is a judgment that Congress made. The Investment Company Act in the first instance delegates responsibility to the board of directors to approve fees. A fee may not be approved that does not have the consent of a majority of the independent trustees in the first instance.

The independent check on fees that is erected by section 36(b) --

JUSTICE SOTOMAYOR: Let's assume -- let'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 this act?

MR. DONOVAN: It may not and it may give

rise to a cause of action. But as I started --

JUSTICE SOTOMAYOR: Which cause of action --

MR. DONOVAN: A cause of action --

JUSTICE SOTOMAYOR: -- under what?

MR. DONOVAN: It may give a cause of action under section 36(b) if the circumstances you described, Justice Sotomayor are -- have an impact upon the fee. And the reason --

JUSTICE SOTOMAYOR: So, then their process is part of your definition of "fiduciary duty"? A court has to look at the nature of process?

MR. DONOVAN: If there is an impact upon fee that is outside of the range of what could have been bargained. The reason for that --

JUSTICE SOTOMAYOR: Now -- now you are adding what has been added, which is outside of the range, correct?

MR. DONOVAN: Yes.

JUSTICE SOTOMAYOR: All right.

MR. DONOVAN: If I understand your question correctly, will a process flaw alone justify a section 36(b) cause of action? My answer is no. Will a process flaw that affects a fee justify a 36(b) action? Yes, it will.

JUSTICE SOTOMAYOR: All right. But what you

are -- but what you are arguing is, if the process is fair, even if the fee is outside the range of an arm's-length transaction, there is no cause of action?

MR. DONOVAN: No, I -- I -- I doubt that as well. There are two separate causes of action, I can imagine, under 36(b): One, a process flaw that has a fee impact; and second, a fee that is so far outside of the bounds of what could have been bargained that it justifies independent review.

The question under 36(b) is whether, having delegated responsibility in the first instance to a board, there is a reason to second-guess their judgment. And the independent check that Mr. Gannon referred to at section 36(b) or (a) should not be a de novo judicial review of the size of the fee for a couple of reasons, the first of which is section 36(b)(2). That statute instructs courts to give such consideration as they consider due to the deliberations of the board. What did they see? What did they get? Did they negotiate?

JUSTICE SCALIA: That's a wonderfully clear command, isn't it? Such consideration as is appropriate? What is the language? Read it. What is it?

MR. DONOVAN: The language is "such consideration that the court considers due under the

circumstances."

JUSTICE SCALIA: Wow.

(Laughter.)

MR. DONOVAN: But there would be no reason for that instruction at all, Your Honor, if a court were to make its own judgments about what is fair and reasonable.

JUSTICE SCALIA: No, it's meaningless. It tells the court to make its own judgment. Such consideration as the court deems due. Give it whatever -- whatever consideration you -- you feel like. It's utterly meaningless to me.

MR. DONOVAN: What I think Congress was doing was considering what the source of the common law had been before. The corporate context, Justice Kennedy, I think was what inspired. At corporate law, a decision would not be second-guessed by a court unless there was a reason to do so, unless the judgment of directors and the presumption of regularity that attached to their decisions could for some reason be second-guessed. Was there a process flaw? Was it so far out of bounds?

CHIEF JUSTICE ROBERTS: Well, what is "so far out of bounds"? In other words, you are saying, you can look at what the directors did if it's, as you said,

too far out of bounds, but 10 percent off, 50 percent off?

MR. DONOVAN: Mr. Chief --

CHIEF JUSTICE ROBERTS: Double, as they say is the case here?

MR. DONOVAN: I'm sorry?

CHIEF JUSTICE ROBERTS: Double, as they say is the case here?

MR. DONOVAN: As the plaintiffs say is the case here.

CHIEF JUSTICE ROBERTS: Yes.

MR. DONOVAN: I suggest there is no numerical basis, because in fact every kind of mutual fund and ever stripe of mutual fund is different.

CHIEF JUSTICE ROBERTS: Well, then you say: Look to see if it's outside the bounds, and now you tell me there is no way to look to see if it's outside the bounds.

MR. DONOVAN: 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.

JUSTICE SCALIA: Is that the test that the court of appeals here applied?

MR. DONOVAN: Pardon?

JUSTICE SCALIA: Is that the test that the court of appeals here applied, whose judgment you want us to affirm?

MR. DONOVAN: The court of appeals did not apply the test. Judge Easterbrook --

JUSTICE SCALIA: So we should remand it for application of the test that you propose?

MR. DONOVAN: I don't think you have to. And the reason is because of what the district court did. And there I get to, Justice Ginsburg, what you said. The -- the argument is made that services are the same. In fact, that is not the record. And if you look at page 161 of the Joint Appendix and following, there is a list of services that the trust -- the investment adviser gave to the trustees in this case, about all of the services that they did for their fee in the case.

JUSTICE SCALIA: Surely that's a disputed fact, isn't it? And you want us to dispose -- or you

want this to be disposed of on summary judgment. The other side says the services aren't that much different.

MR. DONOVAN: They are very different. Page 161 and following will tell you how. And the district court at page 360 -- 16a, excuse me, of the district court's opinion, notices that the services were different. So, under --

JUSTICE SCALIA: It wasn't talking about this particular case. It was talking about in general, wasn't --

MR. DONOVAN: No, he was talking about this case, Justice Scalia.

JUSTICE SOTOMAYOR: Except that they claim that you were receiving additional payment for the services, or some or at least a substantial number of the services, that you claim are attributed by the difference. So they're saying if you compare apples to apples, you are charging twice the amount. If you compare apples to oranges, there are differences because the oranges were different, but you were getting paid for those oranges separately. I think that was their argument.

MR. DONOVAN: That is their argument and it's not accurate, Your Honor.

JUSTICE SOTOMAYOR: Well, that's the issue

of disputed fact. So let's go back. Are you disavowing the Seventh Circuit's approach? Because I read your brief and it doesn't appear as if you are defending their market approach that says so long as the process was fair, any fee is okay. That's how I thought they had reached their conclusion.

MR. DONOVAN: I think what Judge Easterbrook said, and we don't agree, is if there is deceit of directors that would justify a cause of action under 36(b). But in the absence of, in his words, "pulling the wool over the eyes of the trustees" --

JUSTICE SOTOMAYOR: That's what I'm talking -- I am using his words in terms of case --

MR. DONOVAN: I do --

JUSTICE SOTOMAYOR: And you're disavowing that?

MR. DONOVAN: I do not defend that, because I can imagine, as your hypothetical asked earlier, directors or trustees who -- are not paying attention --

JUSTICE SOTOMAYOR: Your positions is no different than the solicitor general's, that there has to be some measure of fair process and some measure of a fair fee, at least within -- in terms of it not being outside the range an arm's length transaction?

MR. DONOVAN: The solicitor general gets it

right when she describes Gartenberg as the standard. Is this a result that could have been fairly bargained at arm's length. Where we part company is with respect to two things: One is, she says and Mr. Gannon said today, that the most important consideration is a comparison to other kinds of fees, and that is required in the calculus in the district court. In fact, that would make mandatory what the SEC rules only make discretionary.

Chief Justice, you asked earlier about the SEC's rules in this area. And in fact, they compel disclosure of fees charged by advisers to their funds and their conflicts of similar investment objectives. They do not require disclosure of accounts within an advisor's business operations that are institutional accounts. Now to be sure --

JUSTICE SCALIA: That are what?

MR. DONOVAN: That are -- advisers -- institutional accounts adviser services. If --

JUSTICE GINSBURG: But the -- the fund adviser here -- I mean, the investment adviser did disclose -- that's in the record -- did disclose the difference between what were charged mutual funds, what were charged institutional investors, and then explained that the services were different and that justified the

difference. But they weren't trying to think, no, we don't have to come forward with this information.

MR. DONOVAN: That's precisely correct, Your Honor. In this case the trustees did have the information. The adviser did disclose it, but the SEC does not require them to ask that question. All it requires them to do is if they do ask the question, if they do study the material, they must disclose the weight they put on to it.

JUSTICE BREYER: Suppose you were appointed to a committee, just set my pay, that might be helpful. I'd say I'll pay you $50,000 a year to do it, as long as I am satisfied with your results.

Now, would you, for example, not have in your mind, I would like to know what he's paid by other people that don't have someone like me setting his pay? Wouldn't that be in your mind?

MR. DONOVAN: It could be, sure.

JUSTICE BREYER: Yeah, so wouldn't that be a normal question to ask?

MR. DONOVAN: And the trustees did ask it here.

JUSTICE BREYER: Well, I don't know if they asked it -- I mean, I think we are reviewing the district court opinion, I think we are reversing -- we

are reviewing -- sorry. We're reviewing.

(Laughter.)

JUSTICE BREYER: I have laryngitis; I don't speak accurately.

(Laughter.)

JUSTICE BREYER: I think we are reviewing a -- a decision of a court of appeals setting a standard, and so wouldn't, when we set the standard, say, we can't say if in every case you are not going to go out and ask him what he charges when he mows the neighbor's lawn, but we would like to know what he charges when he asks for money from people who do not have this kind of supervision, and we would like if it's a lot different to ask him why.

MR. DONOVAN: Justice Breyer --

JUSTICE BREYER: Okay, so what's the problem then with saying that in the opinion?

MR. DONOVAN: There is no problem with saying that if it is a relevant consideration.

JUSTICE BREYER: Well, it's pretty unusual that it won't be, and I think certainly you have in the case in front of us a case where it would be relevant. You may have an answer to the question. There may be a perfectly good answer, so let's listen to it.

MR. DONOVAN: The difference, Your Honor, is

that the Solicitor General and the plaintiffs would make the question and the answer dispositive in every case. I would acknowledge as --

JUSTICE BREYER: The answer dispositive? Well, I don't see it should be dispositive, maybe the answers would be quite different.

MR. DONOVAN: Precisely.

JUSTICE BREYER: All right. So -- but you no objection, then I'm not sure there is much of an issue. There might -- I mean, maybe there is some. That's the only issue, whether this should be dispositive always, or whether it should be a factor to take into account where relevant?

MR. DONOVAN: It is a factor that I consider that is likely to be relevant --

JUSTICE BREYER: So you have no objection to send it back and say look, of course this is relevant, perhaps quite often relevant; why don't you look at it?

MR. DONOVAN: My objection -- my objection to sending it back is only that that analysis was done.

JUSTICE GINSBURG: But did -- but in the Seventh Circuit, Judge Easterbrook said, mainly you have to look to see if there was full disclosure, and then there might be cases where it's so out of line. And he said the comparison would be to other mutual funds. He

excluded the comparison with institutional investors. So to that extent, was the Second Circuit wrong, saying this is not a relevant factor; what other mutual funds pay investment advisors may be a relevant factor?

MR. DONOVAN: I think the Seventh Circuit made that comparison. Judge Easterbrook did say that the services of institutional accounts ordinarily are different from mutual fund accounts. I agree that in the first instance, the first comparator usually should be mutual funds, and regrettably Judge Easterbrook did not cite to the record for the reasons to identify those differences. But it is in fact in the record, and there is no other record that suggests that they were the same. All we had below was the assertion that on the one hand, an advisory contract for an institutional account said advisory services. And in the other we had a mutual fund advisory contract that said advisory services.

CHIEF JUSTICE ROBERTS: When you say you should look at the range and how far it's off, do you mean that in the Gartenberg sense -- in other words, if it is way out of line, then you assume or can at least look further at whether there was a fair process? Or do you mean it in the normal case, in sort of setting the rates you just look how far it is off.

MR. DONOVAN: I look at it in the Gartenberg sense, Your Honor. And the reason is because as I -- from what I said the first question is, is when do you ask courts to substitute their judgment?

CHIEF JUSTICE ROBERTS: It's probably -- you're not the person to -- to ask, but do you understand the Solicitor General's position to be your understanding of the Gartenberg sense or something else?

MR. DONOVAN: I believe they interpret in the Gartenberg sense. I think that the Solicitor General's position and the Respondent's, with respect to the standard that you ought to apply, is Gartenberg.

JUSTICE BREYER: What do we do about Gartenberg? That is to say, the key sentence you can read either way. The key sentence could mean -- it just depends on tone of voice. You must charge a fee that is not so disproportionately large that it bears no reasonable relationship to the services rendered and could not -- could not have been the product of arms-length bargaining. Or you could say, look, it's unlawful where it's so large -- it doesn't -- where there is no reasonable relationship. And if there is no reasonable relationship, how could it have been the product of arm's-length bargaining?

MR. DONOVAN: I agree you can turn the words

upside down. I think they turned it upside down --

JUSTICE BREYER: You object if we turn them upside down?

MR. DONOVAN: I think they turned them upside down for a reason, and the reason is 36(b)(1), which imposes the burden of proof upon --

JUSTICE BREYER: Well, I'm saying the tone, be a little careful here.

MR. DONOVAN: Well --

JUSTICE BREYER: So we can say the substance is -- I'm just trying this out -- the substance is to look and see if it's reasonable, and if it's reasonable it certainly is the product of arm-length bargaining, if it's not reasonable, how could it be? Got to get an answer to that, okay? So, that way you see the tone is be careful, you are a judge, you are not a rate-setter. How's that?

MR. DONOVAN: I would accept the proposition that it is reasonable if it is outside of what could have been bargained at arm's length. I think they turned it upside down the fact for the reason that the statute reverses the burden of proof and I think that they also acknowledge that it is a process-oriented thing for judges to do, because after all you are asking here a standard for judges to apply in a contested

situation that recognizes the responsibility of the board in the first instance. That's what 36(b)(2) is all about.

JUSTICE SCALIA: Would -- would you give us the citations of the parts of the record that you say render it unnecessary for us to remand for the lower court to consider a comparison with non- -- with institutional charges?

MR. DONOVAN: Yes, Your Honor. I start at page 16a and 17a of the district court's opinion where at page 16a at the bottom the district court said the services supplied are different. And --

JUSTICE SCALIA: At 16a of the Joint Appendix you are talking about?

MR. DONOVAN: I'm sorry, Your Honor, the petition.

JUSTICE SCALIA: Of the petition.

MR. DONOVAN: Correct, it's 16a of the petition, which is Judge Kocoras' opinion. At the bottom of the page you will see that he said, the services Harris provided to institutional clients varied but in all events were more limited than those provided the funds.

If you then go on to page 17, he goes through with respect to each of these three funds and

chronicles the fees they paid and by comparison the fees charged to institutional accounts with similar investment objectives. The statement by the plaintiff, Petitioners here, that the fee charged was a 2X multiple, does not refer to that array of institutional accounts. It takes one in order to make the comparison what it is.

And then, Justice Scalia, I would then go to page 32a of the district court's opinion where he describes what appear to be disputed issues of fact. And what he said those dispute issues of fact were about were what the Petitioners claimed were flaws in the negotiation process, in substance, what they would have done had they been negotiating, rather than the trustees. It is not a dispute about the ultimate test, was this fee so far out of bounds it could not have been reasonable.

To be sure, throughout a record that is as large as this one, you could imagine the parties disputed lots of things. What you could not fairly dispute is whether these fees, for these funds, using comparable funds and using institutional accounts, as Judge Kocoras did, were so far out of bounds, they could not have been fairly bargained, and if that is the test, there is no need for remand.

If, as I suggest and as the Solicitor General suggests, Gartenberg is the appropriate standard, Gartenberg is what the district court applied.

This Court has to be sure, on occasion, and it is rare, both announce the test and apply it in the same circumstances.

In circumstances where courts are looking for guidance on what the standard is and how to apply it, I suggest this is a case in which affirming what the district court did would be appropriate.

JUSTICE GINSBURG: What about the petitioners' allegation that the investment adviser did not provide full and accurate information? And they mention particularly concerning economies of scale, profitability, and several other matters, that what everybody agrees is necessary, full disclosure, had not occurred.

Is that a disputed issue of fact or of further inquiry?

MR. DONOVAN: I don't think it is, Your Honor. And, again, I would go back to what Judge Kocoras said on 32(a).

There was absolutely suggestions in the record by the plaintiff that they would have negotiated differently, but, for example, with respect to

ostensible misrepresentations on -- among other things, profitability and the rest, this was because the plaintiffs' expert did an accounting and accounted for costs differently and said, had you accounted for costs and allocated them the way I did, you would have reached a negotiated result that was different.

Well, that just isn't what happened. That's why Judge Kocoras said, this goes to the integrity of the negotiation. Would the negotiation have been different?

The plaintiffs say, I would have done it differently, but that's all they said, and it's not a misrepresentation to say, I would have accounted for costs differently.

Finally, I would -- the other question you asked is where in the record -- Justice Scalia, I'm sorry. It's at page 161 and following, where the background of all the difference in fees and the difference in services is chronicled.

You can tell, from the pull-out charts at page 171, what fee is charged for each of these mutual funds and what fee is charged for institutional accounts.

If you take the plaintiffs' point of view and say that a comparison to institutional accounts is

always required and may be dispositive and is always a fraction of what mutual fund charges and that judges are the, in the first instance, the ones to decide who is fair and reasonable or what is fair and reasonable, as opposed to directors, I suggest you consign 8,000 mutual funds to a trial.

On this record, these were funds that had best in class performance for fees that were at or below industry averages.

That is not a record upon which a reasonable person could conclude that the adviser has over-reached. That is at the heart of fiduciary duty. I see my time is about to expire.

Thank you, Your Honor.

CHIEF JUSTICE ROBERTS: Thank you, counsel.

Mr. Frederick, you have three minutes remaining.

REBUTTAL ARGUMENT OF DAVID C. FREDERICK

ON BEHALF OF THE PETITIONERS

MR. FREDERICK: At this recording here did not make findings -- this was a summary judgment case, and in fact, the Court didn't find that the disputes were nonexistent.

In fact, on page 30a, the district court said that the disputes were nonmaterial, and that's a

very important distinction because the joint appendix that you have before you contains a lot of evidence in which it is disputed whether or not these were similar services.

The Harris manager on page 6 -- JA 650, the portfolio holdings of the funds, are very similar. On 512, the Harris fund manager testimony that, when he buys a stock, he buys it for all mutual funds and independent accounts, with the same investment objective.

On 505 to 506, the Harris research director testimony that the managers of the mutual funds and independent accounts share equally all work done by the research department, and 513 to 514, that the Harris fund manager says all of our analysts do research for all of our clients.

There is disputed evidence here as to what constitutes similarity, Justice Sotomayor, these are comparing apples to apples because the record indicates that there are separate contracts for the additional fees that they charge to the mutual funds for the additional services provided.

We're simply talking about comparisons of money management, but --

CHIEF JUSTICE ROBERTS: Was your friend

correct, that these funds have better than average performance and lower than average fees?

MR. FREDERICK: In one small aspect of the damages period, that is correct, and after that was found, they had lower than average performance and higher than average fees, Mr. Chief Justice. It's a damages period that encompasses several years.

If I could go back to the point, though, about the fiduciary duty, what Judge Cardozo, when he was on the New York Court of Appeals, said, a fiduciary represents the punctilio of honor, and that is contrasted with the morals of the marketplace operating at arm's-length.

It surely cannot be the case that, where you are dealing with a fiduciary duty -- which is a higher standard recognized in the law -- that you can charge twice as much as what you are obtaining at arm's-length for services that you are providing.

The Gartenberg court, Justice Breyer, in fact, had the opposite language that you are averting to, and that is at page 694 F.2nd 928, where the Court said, "The test is essentially whether the fee schedule represents a charge within the range of what would have been negotiated at arm's-length in the light of all the surrounding circumstances."

JUSTICE BREYER: I thought, by reversing that, picking out what the essence was, you would get pretty close to what you are arguing for, without getting into all this thing of whether it's just like a trustee or whether a lawyer should be a trustee or -- you know, there are a lot of questions here that could float around, of any language we use.

MR. FREDERICK: That's right. The Second Circuit that went on to flip it and say, we had to prove a negative, which is not ordinarily what a plaintiff has to prove in any law case, by showing it -- it is so disproportionate it could not have been achieved at arm's-length, and that is where we think the court -- courts have gotten this wrong.

CHIEF JUSTICE ROBERTS: Thank you, counsel.

The case is submitted.

(Whereupon, at 10:57 a.m., the case in the above-entitled matter was submitted.)