Schlichter Sanctioned For 'Reckless' Litigation

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LITIGATION

Determining that the decision to pursue litigation was "objectively reckless," a federal judge has sanctioned the law firm of Schlichter Bogard & Denton with a fine of (up to) $1.5 million.

"When dealing with a lawyer, the courts 'are entitled to demand that an attorney exhibit some judgment. To excuse objectively unreasonable conduct by an attorney would be to state that one who acts with an empty head and a pure heart is not responsible for the consequences,'" the judge wrote—going on to cite another decision that declared that "any conduct that, viewed objectively, manifests either intentional or reckless disregard of the attorney's duties to the court, is sanctionable"—and this court added emphasis to the phrase "*intentional or reckless*."

The Case

The suit—which was **dismissed in August**—was actually two suits, brought by participants (Obeslo, Hall and Gorrell-Deyerle) in plans that had chosen Empower as recordkeeper, and investment options from Great-West and other fund complexes from which participants could choose. Plaintiffs claimed that the fees charged by Defendants Great-West Capital Management, LLC (GWCM) and Great-West Life & Annuity Insurance Co. (GWL&A) violate § 36(b) of the Investment Company Act of 1940 (ICA), which prohibits fees that 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."

There had been signs of trouble as the case wound its way to trial. In **the sanction order**, U.S. District Judge Christine M. Arguello (who was also the judge in the litigation) writes that "in spite of the red flags that Defendants and the Court raised with respect to Mr. Meyer's opinions, Plaintiffs proceeded to trial, relying on Mr. Meyer as the sole means of calculating the amount of damages they allegedly suffered." That said, she went on to note that "when he testified, Mr. Meyer was thoroughly discredited. For instance, he went as far as admitting that some of his opinions were implausible and 'probably shouldn't have [been] included' in his report. His complete lack of credibility as to the element of damages dealt a fatal blow to Plaintiffs' case."

benchmark for a § 36(b) violation."

Now, Judge Arguello notes that the plaintiffs here argue that they "provided extensive evidence and reasonable arguments for what [a] reasonable fee would have been, even apart from the opinion of their expert witness." However, she noted that argument "underscores a fundamental misunderstanding of what constitutes a § 36(b) violation. The fact that Defendants could have charged fees that were lower than what they actually charged is largely irrelevant unless their actual fees exceed 'the outer bounds of arm's length bargaining'…." More succinctly, she wrote that "simply stating that an investment advisor could have reasonably charged another fee, without more, amounts to rate regulation. Therefore, the evidence to which Plaintiffs refer could not independently support a § 36(b) claim without Mr. Meyer's opinion of what that evidence showed."

As for Meyer's opinion, in her August decision, Judge Arguello called out the plaintiff's expert (J. Chris Meyer) as being "thoroughly discredited on cross examination." The decision concluded by explaining that there were "abundant examples of other weaknesses and inconsistencies in Mr. Meyer's testimony which the Court will not list in detail. Suffice it to say, the Court found Mr. Meyer's testimony to be non-credible. Moreover, in addition to the general inadequacy of his testimony, his specific theories regarding Plaintiffs' alleged damages are legally flawed."

(Not) Making the Case

Referring to Meyer's testimony as "the essential piece of Plaintiffs' case," in establishing not only that the fees were "outside of what could have been negotiated at arm's length," as well as the amount of damages suffered, the court noted that "plaintiffs' counsel must have realized the weaknesses in Mr. Meyer's testimony that were likely to be exposed on cross examination, as well as the fatal legal flaws upon which his opinions were based." And even if it chose to "overlook Plaintiffs' failure to appreciate the depth of the flaws in Mr. Meyers opinions, sanctions under § 1927 would still be warranted," since if the plaintiffs' attorneys "objectively reviewed the evidence[i] in this case, that fact would have been as obvious to them as it was to the Court.

"At that point," Arguello explained, "the prudent course of action would have been to voluntarily dismiss the case, especially when no plaintiff—many of whom likely had better experts and stronger claims—has ever prevailed on a § 36(b) claim in 50 years of the statute's existence. Proceeding to trial under those circumstances was, therefore, objectively reckless." That "reckless choice cost Defendants millions of dollars litigating this case and wasted valuable judicial resources which could have otherwise been allocated to the resolution of meritorious claims brought by deserving litigants."

'Lawyer Driven'

She also noted that, "to make matters worse, Defendants accurately point out that Plaintiffs' decision to continue through trial was inherently lawyer driven. Plaintiffs' counsel manufactured this case by placing an advertisement in the newspaper seeking individuals to join the suit." She notes that the "manufactured nature of the case" was evident at trial when the named Plaintiff, Joan Obeslo, "persuasively testified that when she reviewed her retirement account during the relevant period, it "was making money every time. It kept going up, which is what I wanted."

Indeed, she noted that "none of the other testifying Plaintiffs indicated that they were unsatisfied with Defendants' services prior to joining the suit. Each Plaintiff was generally satisfied with the services they received and stood to gain a relatively small amount if they prevailed at trial. On the other hand, Plaintiffs' counsel stood to gain tens of millions of dollars." Consequently, she noted that it was "reasonable to deduce that Plaintiffs' attorneys had a strong incentive to continue to litigate, even when it became clear that they should not.

"In summary, Plaintiffs' attorneys were undeterred by the signs that their case was fatally flawed; they recklessly proceeded to trial in violation of their duty to objectively analyze their case," and tha
plaintiffs' attorneys to be "personally liable for Defendants' excess costs, expenses, a