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American Funds Cases On Hold Pending Supreme Court Decision

By Peter Ortiz March 4, 2010

Plaintiffs who lost a lawsuit against **American Funds** over alleged excessive 12b-1 fees plan to appeal the court's decision.

They filed a notice of appeal with the Ninth Circuit last month but also said they will ask to stay the appeal pending the Supreme Court's decision in Jones v. **Harris Associates**. Los Angeles federal court judge Gary Feess ruled in Corbi v. American Funds and **Capital Research Management** that the firm did not violate its fiduciary duties under 36(b) of the Investment Company Act of 1940.

It's the latest example of an excessive-fee case that essentially has been put on hold because of the Supreme Court's coming decision on Jones v. Harris.

But the fund industry's wait for the important ruling may be nearing an end. The Supreme Court has issued opinions on several other cases that it heard around the same time as Jones v. Harris, and some fund attorneys say they expect the decision soon.

"The fact is that the Supreme Court decision is going to be extremely instructive for the future of 36(b) litigation," says Janine Pollack, a partner at **Milberg** and an attorney for the plaintiffs in the American Funds case. "Everyone involved in these cases is holding their breath."

She says the Supreme Court is expected to issue a decision anytime between now and May. They can go as far as late June, but beyond that is unlikely, she says.

Pollack says regardless of what the Supreme Court decides, they will appeal the recent verdict in the American Funds case. What they do on appeal "is dependent on what comes out of the Supreme Court," she says.

"While ultimately they are hoping to reverse the district court, at the moment they are asking...to wait until Jones is decided and then see what happens," notes Tom Gorman, partner at **Porter Wright Morris & Arthur**, in an e-mail response to questions.

American Funds is fighting another battle on the excessive-fee front, and that has been slowed as well by the wait for the Supreme Court's decision. In a Feb. 19 filing in the same California court, Judge Feess ordered a stay of the case Korland v. Capital Research and Management Company until the later of two events take place – the Corbi appeal is resolved and the Supreme Court issues its decision in Jones v. Harris.

Plaintiffs' attorneys are acutely aware that the Supreme Court decision could have implications for how courts treat excessive-fee cases going forward as well as their cases now in litigation. For nearly three decades, the reigning legal standard used by the lower courts in deciding such cases has largely benefited the fund industry; although, the amount plaintiffs have reaped in settlements is unknown.

Daniel Pollack, a senior partner at **McCarter & English**, notes it will be "virtually impossible" for the plaintiff to succeed in overturning the Los Angeles court's decision that American Funds did not violate its fiduciary duties under 36(b) of the Investment Company Act of 1940. But he also suggests there is less certainty as to how the Supreme Court decision in Jones v. Harris could change the governing standards.

"How Jones v. Harris Associates, in the Supreme Court, will play into the governing standard for section 36(b) is the [big] question, and no one knows that as yet except the nine justices in Washington," Pollack writes in an e-mail response to questions.

While American Funds won its case, it did not escape criticism of its practices. Feess criticized the funds' directors for their failure to vet management vigorously about the fee evaluation process and compensation. Instead, when management justified their compensation levels as necessary to meet competition, the directors "simply accepted that claim as gospel."

American Funds "continues to believe the plaintiffs' case is without merit and are confident that the judge's decision in our favor will be upheld," says company spokesman Chuck Freadhoff.

Niels Holch, president of the Coalition of Mutual Fund Investors, says a Supreme Court ruling that changes the long-held standard could require another look at "how those standards apply in the California cases." But speaking specifically on 12b-1 fees, Holch says ultimately the Securities and Exchange Commission may have to step in.

The Corbi ruling was the culmination of a five-year battle for American Funds, where plaintiffs alleged that Capital Research and American Funds Distributors charged excessive management, 12b-1 and servicing fees to eight funds from 2004 to 2007.

"I was very disappointed in the rulings because I think 12b-1 fees are not being used for what they originally were intended," Holch says. "It puts more pressure on the SEC to begin the 12b-1 rule-making process."

As part of its appeal, plaintiffs are asking the Ninth Circuit to review whether the district court applied "an improper standard in deciding that the defendants were not liable under Section 36(b)...." Plaintiffs also ask if it was improper for the court to deny their request for the firm's employee compensation and profit-sharing data as well as audit work papers of the firm's auditor.

With the Supreme Court expected to issue its decision soon, plaintiffs in the American Funds case will have two options, Gorman notes.

"If that decision [Jones v. Harris] uses a different standard, then they can ask that the case be heard on the merits in view of Jones or that it be remanded for the district court to reconsider in view of Jones," he writes.