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Ruling on Fund Fee Case Is a Relief to Industry

Both the mutual fund industry and advocates for fund shareholders found something to like in the U.S. Supreme Court's decision Tuesday regarding fund fees.

In its ruling, the court did not uphold an appeals court's new, tougher standard for shareholders who want to challenge what they consider to be excessive fees. They instead effectively restored a standard that had been in place since the early 1980s.

"This is really restoring the status quo," said Mercer Bullard, president of Fund Democracy, an advocacy group for mutual-fund shareholders.

Niels Holch, executive director of the Coalition of Mutual Fund Investors, a Washington-based advocacy group, called the decision "a step in the right direction," which "certainly upholds and clarifies the Gartenberg standard." But he noted it's still up to the lower court to interpret the higher court's language.

Under the Gartenberg decision, a fund adviser breaches its fiduciary duty to shareholders if it charges a fee "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."

Paul Schott Stevens, president and chief executive of the Investment Company Institute, the mutual-fund industry group, said the decision reinforces the Gartenberg standard and "confirms the line of judicial decisions that have grown up over time" around the Investment Company Act of 1940. It "provides certainty and clarity that will be helpful to boards and advisers, and ought to be reassuring to shareholders as well."

The high court ordered a federal appeals court in Chicago to reconsider the case, in which three investors in Oakmark Funds sued Harris Associates, the funds' creator and adviser, alleging it breached its fiduciary duties by charging excessive fees to individual investors compared with those charged institutional shareholders. The appeals court had set a tougher standard, saying shareholders must show that an adviser misled a fund's director.

Bullard called Tuesday's ruling "a unanimous body slam" to the new standard set by the appeals court, which opined that competition in the marketplace would assure the fairness of mutual fund fees. "That was explicitly rejected by the Supreme Court."

The case was closely watched by the mutual fund industry, which feared the court could create a new standard for setting fees and possibly open the gates to a flood of litigation.

The high court's decision doesn't open the floodgates to such challenges, and settles the important issue of how fee comparisons should be handled, Stevens said.



The high court recognized there may be significant differences between services provided by an investment adviser to an institutional investor, such as a pension fund, and a smaller retail account, such as a mutual fund. "If the services rendered are sufficiently different that a comparison is not probative, then courts must reject such a comparison," it said. "Even if the services provided and fees charged to an independent fund are relevant, courts should be mindful" that the Investment Company Act doesn't necessarily ensure fee parity between different types of clients, it said.

The decision appears to leave the door open for an investor to argue a wide fee disparity ought to be examined if "hugely different" advisory services between a retail investor and an institutional investor aren't involved, Holch said.

"The opinion goes out of its way to emphasize and caution courts against making inapt comparisons and basically says, "If the services are different, then courts must reject such a comparison," Stevens said. It seems to mean that "comparisons are likely to be the exception, not the rule."

Laura Lutton, analyst at Morningstar Inc., said the decision clearly was good for mutual funds. "They're going to be able to manage their business the way they have for decades. I think that the case really leaves the onus on the individual investor to really do their homework when it comes to fees."

Burton Greenwald, a Philadelphia-based consultant to mutual-fund and asset-management companies, said he expects the fund industry as a whole to be pleased with the result. "It takes away a lot of the uncertainty that was hanging over the ratification of annual contracts this year," he said. "It's to some degree, a reaffirmation of what the independent directors have followed pretty closely over the years."

David Smith, executive vice president and general counsel at the Mutual Fund Directors' Forum, said, "I think it's generally positive decision for both fund shareholders and for the director community. It reinforces the fact that Congress intended for directors to play the central role in shareholder protection, particularly in negotiating of the contract, and that the court should generally not disrupt the work of a well-functioning board."

Michael Scofield, independent director of Evergreen Funds and chairman of the Independent Directors Council, said the decision recognizes and endorses the oversight provided by mutual funds' independent directors. "Acting as fiduciaries for fund shareholders, independent directors conduct a thorough, rigorous review before they approve a manager's advisory contract and fees."

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