Eighth Circuit Applies *Jones v. Harris Associates* to Reject Excessive Advisory Fee Claim and Extinguish "Defective Process" Liability

In the first appellate interpretation of the Supreme Court's landmark *Jones v. Harris Associates* ruling, the U.S. Court of Appeals for the Eighth Circuit on March 30 upheld the entry of summary judgment for mutual fund adviser Ameriprise and rejected plaintiffs' attempts to base claims under § 36(b) of the Investment Company Act on alleged "process defects" alone. In *Gallus v. Ameriprise Financial, Inc.*, the Eighth Circuit reaffirmed that the *sole* basis for liability under § 36(b) is an advisory 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." The *Gallus* court definitively closed the door on plaintiffs' alternative theory that liability could be warranted based a supposedly "flawed" fee approval process, without regard to the size of the fee.

The suit was brought in 2004 by mutual fund shareholders who claimed that Ameriprise's advisory and 12b-1 distribution fees were excessive in breach of the "fiduciary duty with respect to the receipt of compensation" imposed by § 36(b). The plaintiffs argued that Ameriprise's fees were too high because they compared unfavorably to fees charged to institutional clients, and they claimed the adviser was liable because it allegedly did not give the funds' directors adequate information about the comparison.

In 2007, the District of Minnesota granted summary judgment to Ameriprise. Invoking the Second Circuit's seminal *Gartenberg* standard, it held that the plaintiffs did not present evidence that the funds' fees were "so disproportionately large" that they could not have been bargained at arm's length. On appeal, the Eighth Circuit reversed. It concluded that the district court properly applied *Gartenberg* and the fees passed muster under the "so disproportionately large" standard. But the panel also held that a "disproportionate" fee was "not the only way" to violate § 36(b). It remanded to the District Court to determine whether Ameriprise "obfuscated" information it gave to the fund board, and violated its fiduciary obligation in that way. Ameriprise petitioned for *certiorari* to the Supreme Court.

While Ameriprise's petition for *certiorari* was pending, the Supreme Court decided *Jones v. Harris Associates* and embraced the *Gartenberg* standard as the law of the land. *Jones* definitively established the "so disproportionate" standard to govern claims of allegedly excessive mutual fund fees, reaffirmed the central role of independent directors in negotiating advisory fees, and rejected the plaintiffs' central argument that mutual fund fees should be judged primarily by comparison to fees charged other types of accounts. The unanimous *Jones* Court cautioned that "[o]nly where plaintiffs have shown a large disparity in fees that cannot be explained by the different services in addition to other evidence that the fee is outside the arm's-length range will trial be appropriate."

In light of its decision in *Jones*, the Supreme Court vacated the Eight Circuit's decision in *Gallus* and remanded. The case was sent back to the District of Minnesota, which reinstated summary judgment, and the plaintiffs again appealed.

In a unanimous opinion issued two years to the day after *Jones*, the Eighth Circuit affirmed the renewed entry of summary judgment. The new circuit panel held that the plaintiffs failed to meet their burden to demonstrate that the fee was "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." With respect to the institutional fee comparison, the plaintiffs did not show a disparity in fees that could not be explained by difference in services along with other evidence that the fee was outside the arm's-length range, as required by *Jones*. Importantly, the panel also read *Jones* to foreclose the Eighth Circuit's earlier ruling that a disproportionately large fee was "not the only way" for an adviser to violate its statutory duty. The court held that under *Jones*, alleged deficiencies in the fee approval process may affect the amount of deference given to the board's decision to approve the adviser's fee, but cannot constitute dispositive evidence that fees are excessive. The Eighth Circuit then reviewed the evidence about the fund board's approval of the fee contract and concluded that despite the plaintiffs' arguments of an inadequate information flow, the directors' "process can fairly be described as robust."

Finally, the Eighth Circuit upheld dismissal of the plaintiffs' challenge to Ameriprise's 12b-1 distribution and servicing fees. The plaintiffs argued these fees were invalid because they provided "no net benefit" to fund shareholders. But the court rejected that proposed test and applied *Jones'* "so disproportionately large" standard, concluding that the plaintiffs failed to meet their burden to show the 12b-1 fees could not have been fairly bargained.

Gallus faithfully applies *Jones* and appropriately limits the ultimate basis for advisers' liability to the size of challenged fees. The decision accordingly continues the trend established in *Jones* of foreclosing imaginative arguments by the plaintiffs' bar to expand the scope of § 36(b) liability. It should provide further comfort to advisers and fund boards that a robust negotiating process corroborated by an extensive record is the key to avoiding costly litigation and the potential for damages.

The Ropes & Gray litigation team representing Ameriprise in this case was led by partners John Donovan and Rob Skinner.

For further information on *Jones v. Harris Associates*, see Ropes & Gray's earlier alert here.