THE INVESTORS WEREN'T TRICKED, BUT HOW WERE THEY TREATED? THE SEVENTH CIRCUIT'S NEW DEFINITION OF FIDUCIARY DUTY IN *JONES V. HARRIS ASSOCIATES, L.P.*, 527 F.2D 923 (7TH CIR. 2008)

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I. INTRODUCTION

Nowadays people know the price of everything and the value of nothing.
Oscar Wilde

In an era of economic uncertainty, the debate continues: are Americans better off when the three branches of government are involved in the markets and business? Is financial deregulation the reason for the decline of the global economy in 2008, or did the government cause the crash by overstepping its bounds and setting bad regulations in the early 1990s?[1] Should the government have stepped in and bailed out companies on the verge of bankruptcy, or could the economy have fixed itself?[2] During the financial crisis in the fall of 2008, most attention was focused on defining what exactly the executive and legislative branches should do, or should have done, to keep the American people from losing their homes, savings, investments, and faith in the government.[3]

But what about the judiciary? The role of the judiciary in the financial crisis will likely receive more attention as claims are filed against those

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1. *Compare* Nicole Gelinas, *Storm-Proofing the Economy*, WALL ST. J., Oct. 28, 2008, *available at* http://online.wsj.com/article?SB122513954599373277.html, *with* Associated Press, *Frank: GOP Criticism of Housing Crisis is Aimed at Poor Blacks*, Oct. 8, 2008, http://www.foxnews.com/sotory/0,2933,434464,00.html.
2. *See, e.g.,* Floyd Norris, *OFF THE CHARTS*; *How Voters See the Bailout*, N.Y. TIMES, Oct. 18, 2008, at B3.
3. *See, e.g.,* Associated Press, *House Passes Financial Bailout Bill on Second Try*, CHI. TRIB., Oct. 3, 2008, *available at* http://www.chicagotribune.com/business/chi-biz-house-approves-financial-bailout-oct03,0,6356200.story.

accused of corporate greed and manipulating the markets for their own benefit. Before the global economic crash, but while the recession weighed heavily on the minds of many Americans, the Seventh Circuit issued a landmark opinion for the mutual fund industry.[4] *Jones v. Harris Associates* may have gone unnoticed by most Americans, but legal and financial professionals involved in the mutual fund industry sat up and took notice of not only the substance of the Seventh Circuit's opinion, but also the scathing dissent issued several months later when the court denied a rehearing of the case *en banc*.[5]

The court's opinion in *Jones v. Harris Associates* redefined the fiduciary duty that a mutual fund adviser has to the investors of that fund regarding the amount of compensation the adviser receives from the fund.[6] Section 36(b) of the Investment Company Act imposes a fiduciary duty upon mutual fund advisers, and, in 1982, the Second Circuit issued an opinion that interpreted the meaning of that duty.[7] That opinion established what has come to be known as the *Gartenberg* test, which has been applied not only by the courts for the last twenty-five years, but has also been used as a guideline by mutual fund industry professionals to avoid section 36(b) violations.[8] The Seventh Circuit's *Jones* opinion claimed to "disapprove" the *Gartenberg* approach, but was met with skepticism in both the legal and financial sectors.[9]

In *Jones*, the Seventh Circuit determined that to avoid breaching their fiduciary duty, the only thing all mutual fund advisers must do is disclose to the investors the amount of compensation they will be receiving, and refrain from engaging in trickery.[10] This narrowed definition of fiduciary duty fails to consider the unique and powerful position that mutual fund advisers have to investors, and gives the advisers an extreme amount of latitude. Thus, the new test devised by the *Jones* opinion devoids section 36(b) of the Investment Company Act of any meaning. The *Gartenberg* approach, however, should not be discarded because it allowed courts to determine if mutual fund advisers

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4. *See* Thompson Hine, *Seventh Circuit Rejects Gartenberg Standard in Adviser Fee Case and Fashions New Test*, July 16, 2008, *available at* http://www.thompsonhine.com/publications/publication 1450.html; Ropes & Gray, *Appeals Court Rejects Mutual Fund Excessive Fee Claims, Adopting New Standard for Evaluation of Fees*, May 20, 2008, *available at* http://www.ropesgray.com/ litigationalert /?PublicationTypes.
5. *See* Floyd Norris, *Judges in Dispute Over Mutual Funds*, N.Y. TIMES, Aug. 16, 2008, at C3.
6. Jones v. Harris Assocs., L.P., 527 F.3d 627 (7th Cir. 2008).
7. *See* Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 694 F.2d 923 (2d Cir. 1982).
8. *See Jones,* 537 F.3d at 733 (noting the mutual fund industry's need to know if *Gartenberg* should still be followed).
9. *See* Lori A. Martin & Martine E. Lybecker, *It's Too Early to Disregard the Gartenberg Factors During Advisory Fee Renewals*, WilmerHale E-Mail Alerts (May 27, 2008), http://www.wilmerhale.com/publications/ whPubsDetail.aspx?publication=8329.
10. *Jones*, 527 F.3d at 632.

breached their fiduciary duty by examining the facts and circumstances surrounding the fees the advisers received from the mutual funds.

Section II of this casenote explores the history of the Investment Company Act, specifically section 36(b), which first imposed the fiduciary duty on mutual fund advisers. Then the *Gartenberg* decision will be explained, with an exposition of *Jones v. Harris Associates* following in section III. Finally, the crux of this casenote will illustrate how the Seventh Circuit erroneously disapproved *Gartenberg* with the *Jones* opinion, effectively causing a split among the federal circuits.

II. BACKGROUND

For over seventy years, Congress has recognized that mutual fund investors need certain protections.[11] The Investment Company Act was the first evidence of that recognition, and it has metamorphosed over the years as mutual fund investing grew in popularity.[12] However, some of the statutory language left the door wide open for the judiciary to actually define the protections mutual fund investors need.[13]

A. The Mutual Fund

Today, nearly 100 million Americans invest in mutual funds.[14] The first American mutual fund was created in 1924, but records show that the basic premise of the mutual fund was used in Europe during the early 1800s.[15] In a mutual fund, a group of investors compile their funds for the purpose of achieving greater diversification than the individual investors could on their own.[16] Furthermore, the investors can collectively pay for an adviser, who conducts research and selects fruitful investments for the fund.[17] This is both an advantage and a disadvantage; the average investor does not have a

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11. *See* S. COMM. ON BANKING AND CURRENCY, INVESTMENT COMPANY AMENDMENTS ACT OF 1970, S. REP. NO. 91-184, at 1 (1969), *reprinted in* 1970 U.S.C.C.A.N 4897, 4899-4902.
12. *See, e.g.,* Green v. Nuveen Advisory Corp., 295 F.3d 738, 742–43 (7th Cir. 2002).
13. *Id.*
14. Andrew J. Donohue, Director, Division of Investment Management, U.S. Securities and Exchange Commission, Testimony Concerning Improving Disclosure for Workers Investing for Retirement, Testimony Before the Ways and Means Committee, U.S. House of Representatives (Oct. 30, 2007) *as reprinted in* http://www.sec.gov/news/testimony/testarchive/2007tests.html.
15. Lyn Bell, *A Brief History of Mutual Funds*, Oct. 6, 2007, http://ezinearticles.com/?A-Brief-History-Of-Mutual-Funds&id=770047.
16. U.S. Securities and Exchange Commission, *Invest Wisely: An Introduction to Mutual Funds*, July 7, 2008, www.sec.gov/investor/pubs/inwsmf.htm.
17. *Id.*

financial background that enables him or her to make complex investment decisions, rendering the adviser's services necessary.[18] The disadvantage is, of course, that the fund pays the adviser's fee and other administrative costs, whether or not the fund makes money.[19]

The mutual fund is the most common type of investment tool.[20] An investment company is one that "issues securities[21] and is primarily engaged in the business of investing in securities."[22] The investment company selects an adviser, who will do much more than simply advise; essentially, "the adviser runs the investment company."[23] The adviser not only researches and chooses investments, but is responsible for operating the daily business of the investment company.[24] Because investment companies are entrusted with the savings of millions of investors, and because investment companies are essentially run by investment advisers, Congress enacted The Investment Company Act of 1940.[25]

B. The Investment Company Act

In 1935, Congress recognized that the nature of investment companies made the investors vulnerable and in need of "special legal protection."[26] The Public Utility Act of 1935 instructed the Securities and Exchange Commission (SEC) to conduct a study on investment companies.[27] The SEC's report, while not completely bleak, was cause for significant concern:

> Of course there were many substantial and successful companies, but the picture presented by the Securities and Exchange Commission after a four-year investigation showed fantastic abuse of trust by management and wholesale victimizing of investment company security holders. In general the abuses stemmed from the control of investment companies by banking, brokerage, or dealer interests–a control founded in complicated capital structures, disguised behind meager, and often misleading, reports to

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18. *Id.*
19. *Id.*
20. THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION 685 (West Group 2002) (1985).
21. *See* DAVID L. RATZNER & THOMAS LEE HAZEN, SECURITIES REGULATION 1 (8th ed. 2005) ("securities . . . represent rights in something else," e.g., bonds, stocks).
22. U.S. Securities and Exchange Commission Web site, http://www.sec.gov/answers/mfinvco.htm, (last visited Sept. 20, 2008).
23. HAZEN, *supra* note 20, at 692.
24. *Id*. at 691.
25. *See* S. COMM. ON BANKING AND CURRENCY, INVESTMENT COMPANY AMENDMENTS ACT OF 1970, S. REP. NO. 91-184, at 1 (1969), *reprinted in* 1970 U.S.C.C.A.N 4897, 4899-4902.
26. *Id.* at 4899.
27. *Id.*

> stockholders, and exercised to benefit the sponsor without regard to any stewardship on behalf of the investors who put up the money.[28]

Thus, the Investment Company Act of 1940 was passed and was successful in tempering the abuses that the SEC reported.[29] However, the popularity of mutual funds increased dramatically in the 1950s, and Congress authorized further studies of mutual fund companies.[30] The Senate Committee on Banking and Currency held extensive hearings during the late 1960s and proposed several forms of legislation amending the 1940 act.[31]

Most notable among the proposed legislation was the provision that investment company advisers must charge "reasonable" fees. The courts were given jurisdiction to determine what was "reasonable."[32] The Committee was concerned about fees because as more people invested in mutual funds, advisers to those funds could potentially receive excessive fees since their fees were often based on a percentage of the amount invested, and not on profit returns.[33] This is known as the "economy of scale" concept: in the mutual fund industry, as in other instances, the more clients that an investment company has, the less expensive it is for the company to do business.[34] Thus, the mutual funds were earning more money; however, in some instances, the advisers, not the investors, were seeing higher returns.[35] The Committee's solution was that adviser's fees must be reasonable. However, while the Senate passed the legislation containing the "reasonableness" provision, the House did not vote on the bill.[36] The mutual fund industry made strong objections to the "reasonableness" standard.[37] Finally, the Investment Company Amendments Act of 1970 was passed, and the Senate Report read as follows:

> After hearings and further deliberation, your committee has decided that there is adequate basis to delete the express statutory requirement of

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28. *The Investment Company Act of 1940*, 50 YALE L.J. 440, 441–42 (1941), *citing Hearings before a Subcommittee of the Senate Committee on Banking and Currency on S.* 3580, 76th Cong., 3d Sess. (1940) Pt. I, p. 34; Pt. II, p. 783.
29. S. REP. NO. 91-184, at 4899.
30. *Id*. at 4899–4900.
31. *Id*. at 4902.
32. *Id.*
33. *Id.*
34. *See, e.g,* ROBERT L. HEILBRONER & LESTER C. THUROW, ECONOMICS EXPLAINED 53 (1982) (When there are more customers buying a product, the cost of production is lower for the company making the product. Thus, the company can sell the product for a cheaper price).
35. S. REP. NO. 91-184, at 4902.
36. *Id.*
37. RATNER AND HAZEN, *supra* note 21, at 239.

> "reasonableness," and to substitute a different method of testing management compensation. This bill states that the mutual fund investment adviser has a specific "fiduciary duty" in respect to management fee compensation. This is in accordance with the fact that while the mutual fund is a separate organization it is generally created and, subject to the supervision of the board of directors, is managed by the investment adviser. It also is in accordance with the traditional function of the courts to enforce such duties in similar type relationships.[38]

Consequently, section 36(b) was added to the Investment Company Act,[39] which reads, in pertinent part, "the investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services . . . ."[40] Furthermore, section 36(b) provides that the investors themselves, and not just the SEC, may bring suit against mutual fund advisers for breach of that fiduciary duty.[41] Twelve years later, the Second Circuit Court of Appeals decided a landmark case that would be used to interpret section 36(b) for the next quarter of a century.[42]

C. *Gartenberg v. Merrill Lynch Asset Management, Inc.*

In his 2008 address at the Mutual Fund Directors' Institute, Andrew J. Donohue, Director of Investment Management of the SEC, gave a brief history of section 36(b) of the Investment Company Amendments Act of 1970.[43] He noted that while section 36(b) gave the court jurisdiction to determine if a mutual fund adviser has breached his or her fiduciary duty to the investors, there was little guidance on how to determine if a breach occurred.[44] It was not until 1982 that a court addressed the issue, in a case well-known among the

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38. S. REP. NO. 91-184, at 4902.
39. *Id.*
40. Investment Company Act of 1940 § 36, 15 U.S.C. § 80a-35 (2006).
41. *Id.*
42. *See* Yameen v. Easton Vance Distribs., 394 F. Supp. 2d 350, 356 (D. Mass. 2005), Amron v. Morgan Stanley Inv. Advisors, Inc., 464 F.3d 338, 340 (2d Cir. 2007); Benak v. Alliance Capital Mgmt., L.P., No. 01-5734, 2004 U.S. Dist. LEXIS 12231, at *18 (D. N.J. Feb. 9, 2004); Migdal v. Rowe Price-Fleming Int'l, 248 F.3d 321, 326 (4th Dist. 2001); Hunt v. Invesco Funds Group, No. H-04-02555, 2006 U.S. Dist. LEXIS 40944, at *7 (S.D. Tex. June 5, 2006); Miller v. Mitchell Hutchins Asset Mgmt., No. 01-cv-0192-DRH, 2002 U.S. Dist. LEXIS 27675, at *13 (S.D. Ill. March 12, 2002); Batra v. Investors Research Corp., 144 F.R.D. 97, 99 (W.D. Mo. 1992); Siemers v. Wells Fargo & Co., 23 F.R.D. 369, 374 (N.D. Cal. 2007); Sins v. Janus Capital Mgmt., LLC, No. 04-cv-01647-WDM-MEH, 2006 U.S. Dist. LEXIS 90673, at *7 (D. Colo. Dec. 15, 2006).
43. Andrew J. Donohue, Address at the Mutual Fund Directors Forum Second Annual Directors' Institute (Jan. 15, 2008) (transcript available at http://www.sec.gov/news/speech/2008/ spch011508ajd.htm).
44. *Id.*

financial community.[45] As Director Donohue stated to an audience of mutual fund directors, "I suspect that everyone in the room recognizes the name Gartenberg . . . ."[46]

1. Facts and Procedure

Irving Gartenberg and Simone Andre were investors in the Merrill Lynch Ready Assets Trust, a money market fund[47] managed by Merrill Lynch Asset Management.[48] The fund was organized in 1975, and grew dramatically over the span of a few years, particularly from 1977 through 1981.[49] The dramatic growth was attributed to two factors: (1) the fund was realizing high yields; and (2) it was very easy for investors to get in and out of the fund, meaning they could invest one day and cash out the next.[50] Consequently, investors could literally treat the fund like a bank account, and make money at the same time.[51]

The adviser conducted all the operations of the fund, including providing the fund with "office space and facilities, administrative staff, equipment, portfolio management, compliance with SEC and state recordkeeping and reporting requirements, and services to Fund shareholders."[52] The adviser used a Merrill Lynch affiliated broker to process share purchases and redemptions, as well as the "vast facilities of the Merrill Lynch organization and its affiliates to render special services to the Fund."[53] One of those special services was the ease with which investors could buy or redeem their shares, which then in turn contributed to the fund's dramatic growth.[54] Under this management, the fund performed slightly above average for all similar funds at that time.[55]

For the aforementioned services, the adviser received "an advisory fee based on a percentage of the average daily value of the Fund's net assets."[56]

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45. *Id.*
46. *Id.*
47. *See* U.S. Securities and Exchange Commission, *Invest Wisely: Mutual Funds*, July 2, 2008, http://www.sec.gov/ investor/pubs/inwsmf.htm (a money-market fund is a low-risk type of mutual fund that, by law, can only invest in "high-quality, short-term investments issued by the U.S. Government, U.S. corporations, and state and local governments").
48. Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 694 F.2d 923, 925 (2d Cir. 1982).
49. *Id*. at 925–26.
50. *Id.*
51. *Id.*
52. *Id.* at 926.
53. *Id.*
54. *Id.*
55. *Id.*
56. *Id.*

The adviser received 0.50% of the fund's average daily value of net assets under $500 million. Then, as the average daily value of net assets grew, the adviser gradually received a lower percentage fee, eventually receiving 0.275% of assets above $2.5 billion.[57]

After a bench trial, the district court dismissed the plaintiffs' claims that the adviser's fees were in breach of the fiduciary duty imposed by section 36(b).[58] The judge ruled that the adviser's fees were fair in relation to the services provided."[59]

2. Discussion

On appeal, the plaintiffs argued that the district court should have applied the "reasonableness" standard when determining whether there had been a breach of fiduciary duty.[60] The Second Circuit noted that the legislative history of section 36(b) indicated that the deletion of "reasonable" and the replacement with "fiduciary duty" was "a more semantical than substantive compromise" that shifted the attention from the conduct of the mutual fund directors to the conduct of the adviser-manager.[61] The court also noted that the legislative history and the statute itself failed to guide courts in determining a breach of fiduciary duty; therefore, the "reasonableness" of the adviser's fees can be part of the process of determining an adviser's breach of fiduciary duty to the investors.[62] Thus, the court concluded that whether or not the *name* of the test is "reasonableness" or "breach of fiduciary duty," the *definition* of the test is as follows: "to be guilty of a violation of [section] 36 (b) . . . the adviser-manager must charge a 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."[63]

The Second Circuit established factors to use in determining whether an adviser has failed this test.[64] In general, the factors include (1) "the adviser-manager's cost in providing the service," (2) "the nature and quality of the service," (3) "the extent to which the adviser-manager realizes economies of scale as the fund grows larger," and (4) "the volume of orders which must be

57. *Id.*
58. *Id.* at 925.
59. *Id*. at 927 (citing Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 528 F. Supp. 1038, 1068 (S.D. N.Y 1981)).
60. *Id.*
61. *Id*. at 928.
62. *Id.*
63. *Id.*
64. *Id.* at 929.

processed by the manager."[65] Fundamentally, the court noted that "Congress intended that the court look at all the facts in connection with the determination and receipt of such compensation."[66]

The court also discussed the notion that competition for shareholder business leads to competition for advisers, and thus, advisers will adjust their fees accordingly in response to the market.[67] The court disagreed with this idea, and stated that while the price charged by other advisers of similar funds could be one factor in determining an adviser's breach of fiduciary duty, it should not be the principal factor.[68] First of all, an adviser's fee is immaterial to most investors; for example, in this case, "the alleged excessive [m]anager's fee amounts to $2.88 *a year* for each $1,000 invested."[69] Thus, most shareholders are not persuaded to seek other mutual funds with lower adviser's fees, so there is little incentive for advisers to adjust their fees accordingly.[70] In addition, most advisers are affiliated in such a way with the fund that it is very difficult for the fund to move to a different adviser. The court found that this difficulty in migrating "tends to weaken the weight to be given to rates charged by advisers of other similar funds."[71]

3. Holding

The Second Circuit found that the plaintiffs did not meet their burden of proving that the adviser breached his fiduciary duty to the investors.[72] The substantial increase in the adviser's fees from 1977 to 1981 was attributed to the fund's growth.[73] The court analyzed the economy of scale argument to determine if the adviser's administrative costs increased with the fees received.[74] The court found in this case that administrative expenses had actually increased, and thus the increased fees paid to the advisers were appropriate.[75] Consequently, the plaintiffs failed to prove that the adviser's fees were "so excessive or unfair" or "so disproportionately large" as to

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65. *Id.* at 930.
66. *Id*. (citing S. COMM. ON BANKING AND CURRENCY, INVESTMENT COMPANY AMENDMENTS ACT OF 1970, S. REP. NO. 91-184, at 1 (1969), *reprinted in* 1970 U.S.C.C.A.N 4897, 4910.
67. *Id.* at 929.
68. *Id*.
69. *Id.* (emphasis in original).
70. *Id.*
71. *Id.*
72. *Id.* at 930.
73. *Id.*
74. *Id.*
75. *Id*. at 930–31.

constitute a violation of section 36 (b) of the Investment Company Act, and the district court's dismissal of the plaintiffs' action was affirmed.[76]

The *Gartenberg* test[77] remained the dominant standard in the financial industry for the next twenty-five years.[78] Mutual fund advisers and boards of directors habitually reviewed the *Gartenberg* factors[79] before renewing the adviser's compensation agreement.[80] Nevertheless, in 2008, the Seventh Circuit Court of Appeals issued a decision that caused a commotion in both the legal and financial sectors.[81]

III. EXPOSITION OF *JONES V. HARRIS ASSOCIATES L.P.*

Jones v. Harris Associates L.P. was one of several cases brought against mutual fund companies between 2003 and 2004 alleging excessive adviser fees.[82] The *Jones* decision created a circuit split, and also increased the likelihood that the United States Supreme Court will review a section 36(b) case in the near future.[83]

A. Facts and Procedural History

There are three mutual funds at issue in this case and Defendant Harris Associates (hereinafter "Harris") served as the investment adviser to all three: Oakmark, Oakmark Equity (hereinafter "Equity"), and Oakmark Global (hereinafter "Global").[84] Plaintiffs invested in the three funds; Harris provided "research and stock selection," and was compensated according to a fee

76. *Id.* at 933–34.
77. The *Gartenberg* test asks whether an adviser's fee 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." *Id.* at 928.
78. *See, e.g.,* Migdal v. Rowe Price-Fleming Int'l, 248 F.3d 321, 326 (4th Cir. 2001); Amron v. Morgan Stanley Inv. Advisors, Inc., 464 F.3d 338, 340 (2d Cir. 2007).
79. "The adviser-manager's cost in providing the service, the nature and quality of the service, the extent to which the adviser-manager realizes economies of scale as the fund grows larger, and the volume of orders." *Gartenberg,* 694 F.2d at 930.
80. *See* Martin & Lybecker, *supra* note 9.
81. *See* Lee Anne Cophenhefer, Steven R. Howard, Roger P. Joseph, & Neal E. Sullivan, *Dissent in Mutual Fund Advisor Fee Case Makes U.S. Supreme Court Review More Likely*, Bingham E-Mail Alert (Aug. 21, 2008), http://www.bingham.com/Media.aspx?MediaID=7428; Hine, *supra* note 4; Norris, *supra* note 5.
82. John Morgan, *Oakmark Wins Fee Battle: Ruling Seen as Victorious Precedent*, Money Management Executive (June 2, 2008), www. mmexecutive.com.
83. Copenhefer, Howard, Joseph, & Sullivan, *supra* note 81.
84. Jones v. Harris Assocs., L.P., No. 04 C 8305, 2007 WL 627640 at *1 (N.D. Ill. Feb. 27, 2007).

schedule.[85] Harris's fees were approved after the board of trustees reviewed the funds' performances and the various services performed by Harris.[86] Then the board would compare the fees Harris charged to the fund to (1) fees Harris charged other clients and (2) fees charged by other advisers to similar mutual funds.[87] Upon approval by the board of trustees, Harris would earn a percentage of each mutual fund's assets at the end of each month.[88] For the time period applicable to the suit, the percentages of each of the funds' assets that were paid to Harris as fees are as follows:[89]

MUTUAL FUND	1st break point	2nd break point	3rd break point	4th break point	Fees paid to Harris 9/04	Fees paid to Harris 9/03
Oakmark	1% of first $2 billion	0.9% of next $1 billion	0.8% of next $2 billion	0.75% in excess of $5 billion	$50,652,178	$37,074,474
Equity	0.75% for the first $5 billion	0.7% of next $2.5 billion	0.675% of next $2.5 billion	0.65% in excess of $10 billion	$46,997,810	$23,468,519
Global	1% of first $2 billion	0.95% of next $2 billion	0.9% in excess of $4 billion	None	$12,245,761	$2,982,092

Plaintiff's complaint alleged that Harris violated section 36(b) of the Investment Company Act by breaching his fiduciary duty by retaining an advisory fee which was "disproportionate to the value of its services."[90] After the parties completed the discovery process, each moved for summary judgment.[91] The district court followed *Gartenberg*, noting that it was the "prevailing standard for assessing such claims."[92] Consequently, the plaintiffs' motion was denied and the defendant's motion was granted. The court found that:

85. *Id.*
86. *Id.*
87. *Id.*
88. *Id.*
89. *Id*. at *2.
90. *Id*. at *3.
91. *Id.*
92. *Id*. at *7.

> Plaintiffs tell an elaborate story of what they believed should have transpired between the Funds and Harris in order to produce a deal that would ultimately be more advantageous to the Plaintiffs than the arrangement that was reached. However, the evidence they have adduced establishes at most that others paid different amounts for similar services . . . . Whether the Funds could have gotten more for their money from Harris is irrelevant. What matters is whether there is a fundamental disconnect between what the Funds paid and what the services were worth; on this score Plaintiffs have not set forth an issue of fact that, if resolved in their favor, could lead to a finding that Harris had breached its [section] 36 (b) duty.[93]

Consequently, plaintiffs appealed to the Seventh Circuit Court of Appeals.[94] In May 2008, the court issued an opinion affirming the district court.[95]

B. Reasoning

Chief Judge Easterbrook of the Seventh Circuit authored the court's *Jones* opinion, and noted the primary issue on appeal was Harris's alleged violation of section 36(b).[96] Judge Easterbrook stated that the court would not follow the *Gartenberg* approach because the court was "skeptical about *Gartenberg* because it relie[d] too little on markets . . . ."[97] Judge Easterbrook then cited *Green v. Nuveen Advisory Corp.*, a Seventh Circuit case, and noted that a Third Circuit case, *Green v. Fund Asset Management*, was also in disagreement with *Gartenberg*.[98] He further stated that "our own *Green* opinion . . . indicated sympathy for the Third Circuit's position."[99] Judge Easterbrook concluded:

> Having had another chance to study this question, we now disapprove the *Gartenberg* approach. A fiduciary duty differs from rate regulation. A fiduciary must make full disclosure and play no tricks but is not subject to a cap on compensation. The trustees (and in the end investors, who vote with

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93. *Id*. at *9.
94. Jones v. Harris Assocs., L.P., 527 F.3d 627, 627 (7th Cir. 2008).
95. *Id.*
96. *Id*. at 627–30.
97. *Id*. at 632.
98. *Id.*
99. *Id.*

their feet and dollars) rather than a judge or jury, determine how much advisory services are worth.[100]

Judge Easterbrook then supported the court's decision with two arguments.[101] First, an adviser's fiduciary duty does not mean the adviser must charge what the judiciary deems "reasonable" fees.[102] Additionally, competition among mutual funds will protect the investors' interests because advisers will be conservative with their fees, out of fear that higher fees will drive investors away.[103]

1. Reasonable Fees v. Fiduciary Duty

Judge Easterbrook explained that while section 36(b) creates a fiduciary duty for mutual fund advisers, it does not state that the adviser's fees must be reasonable in relation to a standard set by the courts.[104] He then compared the role of a fiduciary to that of a trustee and cited the *Restatement of Trusts*: "a trustee owes an obligation of candor in negotiation, and honesty in performance, but may negotiate in his own interest and accept what the settlor or governance agrees to pay."[105]

The court's opinion then made two analogies to illustrate the difference between measuring what is reasonable and measuring a fiduciary duty.[106] First, corporations are managed by those who owe fiduciary duties to the investors.[107] However, CEO's salaries, bonuses, and stock options are not scrutinized by courts for their "reasonableness."[108] Second, attorneys have fiduciary duties to their clients, yet as long as the client is well aware of the fees being charged by the attorney, a court will not find the fiduciary duty was breached.[109] Therefore, if the fee paid to a mutual fund adviser is contested, the question to ask "is whether the client made a voluntary choice *ex ante* with the benefit of adequate information."[110]

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100. *Id.*
101. *Id.* at 632–34.
102. *Id.*
103. *Id.*
104. *Id*. at 632.
105. *Id.* (citing Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101, 109 (1989))
106. *Id*. at 632–33.
107. *Id.*
108. *Id.*
109. *Id.*
110. *Id.*

2. *Competition Among Mutual Funds*

The opinion further states that there are many mutual funds for investors to choose from, and investors can easily leave their advisers by moving their money to other funds if the adviser's fees are too high.[111] Judge Easterbrook supports this position by noting the ease with which investors can enter and exit mutual funds, as well as a study that found "investors can and do protect their interests by shopping, and that regulating advisory fees through litigation is unlikely to do more good than harm."[112]

C. Holding

Judge Easterbrook contended that because plaintiffs did not argue that the adviser tricked them, or failed to disclose its fees to them, there is no breach of section 36(b) of the Investment Company Act.[113] The opinion noted that securities regulation laws work by "requiring disclosure and then allowing price to be set by competition in which investors make their own choices."[114] The *Gartenberg* decision was wrong because it allowed judges to be the rate regulators, not the market, and "judges can't be turned out of office or have their salaries cut if they display poor business judgment."[115]

D. Dissent

When the court denied a motion for rehearing en banc, five of the circuit judges dissented.[116] In the dissent, Judge Posner attacked Judge Easterbrook's opinion procedurally, noting that while Judge Easterbrook's opinion created a circuit split, the opinion did not follow circuit split protocol by circulating the opinion to the entire court before publication.[117] Regarding the substance of the opinion, Judge Posner noted that Judge Easterbrook cited the *Green* cases (from the Seventh and Third circuits) in support of his position against *Gartenberg*, but neither of those cases were issues of adviser compensation or

111. *Id.* at 634.
112. *Id.* at 634 (citing *Competition in the Mutual Fund Industry: Evidence and Implications for Policy*, 33 IOWA J. CORP. L. 151 (2007)).
113. *Id*. at 635.
114. *Id.*
115. *Id.* at 633.
116. Jones v. Harris Assocs., L.P., 537 F.3d 728, 729 (7th Cir. 2008).
117. *Id*. at 732.

excessive fees.[118] Furthermore, *Gartenberg* did not constrain the financial industry, because nearly every excessive fee case since *Gartenberg* was resolved in favor of defendant advisers.[119]

Judge Posner remarked that when Judge Easterbrook noted that corporate salaries are not reviewed for reasonableness he was missing the point, because "unreasonable compensation can be evidence of a breach of fiduciary duty."[120] In addition, the economic analysis used by Judge Easterbrook is "ripe for reexamination," because most boards of directors are unwilling to take hard stances on executive compensation.[121]

In the months following the *Jones* decision, the mutual fund industry was hesitant to view Judge Easterbrook's opinion as the final word, and industry consultants and attorneys cautioned mutual fund boards and advisers to continue abiding by *Gartenberg*.[122] Many expected that if this case does not reach the United States Supreme Court a similar one will, so that the circuits are given guidance on the appropriate way to determine if a violation of section 36(b) occurred.[123]

IV. ANALYSIS

The Seventh Circuit incorrectly disapproved *Gartenberg* by determining that mutual fund advisers can avoid breaching their fiduciary duty simply by disclosing to their investors the amount of compensation they will be receiving and by refraining from trickery. The Seventh Circuit's definition of fiduciary duty fails to consider the unique and powerful position that mutual fund advisers have over investors, and gives the advisers an extreme amount of latitude. Thus, the new test devised by the *Jones* opinion devoids section 36(b) of the Investment Company Act of any meaning. The *Gartenberg* approach allowed courts to determine if mutual fund advisers breached their fiduciary duty by examining the facts and circumstances surrounding the fees the advisers received from the mutual funds, and the test should not have been disapproved.

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118. *Id*. at 729.
119. *Id.*
120. *Id*. at 732.
121. *Id*. at 730.
122. *See, e.g.,* Investment Management/Securities Industry FYIs, *Seventh Circuit "Disapproves" of Gartenberg Factors*, May 22, 2008, http://www.imsi.morganlewis.com/2008/seventh-circuit-%E2%80%9C disapproves%E2%80%9D-of-gartenberg-factors/; Richard M. Phillips, Jeffrey B. Maletta, & Mark D. Perlow, *Seventh Circuit Rejects Gartenberg But Not Business Judgment*, K&L GATES NEWSSTAND, June 12, 2008, http://www.klgates.com/newsstand/Detail.aspx?publication=4613.
123. *See, e.g.,* Copenhefer, Howard, Joseph, & Sullivan, *supra* note 81.

A. Fiduciary Responsibilities Involve More than Mere Disclosure

While section 36(b) of the Investment Company Act imposes a fiduciary duty on mutual fund advisers, the *Gartenberg* court noted that the legislative history, as well as the statute itself, failed to give courts guidance on how to determine a breach of that fiduciary duty.[124] However, the *Gartenberg* opinion stated the legislative history of section 36(b) does not designate a substantive difference between advisers charging mutual funds unreasonable fees, and advisers breaching their fiduciary duty.[125]

Using the plain meaning approach to statutory construction, fiduciary duty is defined as "a duty of utmost good faith, trust, confidence, and candor owed by a fiduciary . . . to the beneficiary."[126] A fiduciary is defined as "one who must exercise a high standard of care in managing another's money or property."[127] In 1970, when section 36(b) was enacted, Black's Law Dictionary provided that a fiduciary capacity is a relationship "implying and necessitating great confidence and trust on the one part and a high degree of good faith on the other part."[128] So, while disclosure is a necessary component of great confidence, trust, and good faith, it can hardly be the only component. One component of good faith is "observance of reasonable commercial standards of fair dealing in a given trade or business."[129] Inasmuch as disclosure is part of a fiduciary duty, so is reasonableness when performing that duty.

Judge Posner stated in his *Jones* dissent that the opinion missed the point when it dismissed the idea "that unreasonable compensation can be evidence of a breach of fiduciary duty."[130] Judge Easterbrook's opinion holds a fiduciary duty is breached when full disclosure is not made, and that should be the prevailing test for determining a violation of section 36(b) of the Investment Company Act.[131] Judge Easterbrook compared the role of a mutual fund adviser to that of a trustee: like a trustee, a mutual fund adviser "owes an obligation of candor in negotiation, and honesty in performance, but may negotiate in his own interest and accept what the settlor or governance agrees

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124. Gartenberg v. Merrill Lynch Asset Mgmt., 694 F.2d 923, 928 (2d Cir. 1982).
125. *Id.*
126. BLACK'S LAW DICTIONARY 545 (8th ed. 2004).
127. *Id*. at 658.
128. BLACK'S LAW DICTIONARY 753 (4th ed. 1968).
129. BLACK'S LAW DICTIONARY 713 (8th. ed. 2004).
130. Jones v. Harris Assocs., L.P., 537 F.3d 728, 732 (7th Cir. 2008).
131. Jones v. Harris Assocs., L.P., 527 F.3d 627, 632 (7th Cir. 2008).

to pay."[132] Furthermore, attorneys and CEOs have fiduciary duties, but Judge Easterbrook stated that as long as full disclosure was made, courts do not analyze the fees that an attorney or CEO receives for reasonableness.[133]

However, consider the following scenario: Testator lived in a small town whose primary industry was a factory owned by Testator. Over the years, Testator made millions from the factory. The factory workers were primarily immigrants who did not speak English. Testator had no family of his own, and he saw a great need for the children of the immigrant factory workers to be able to pursue higher education. Testator created a trust for the children of factory employees that would go into effect upon his death. Considering Testator's net worth, thousands of the employees' children would be able to go to college, all expenses paid.

Upon Testator's death, the local bank, Trustee, sent out a letter to the factory employees. It explained the terms of the trust, including a disclosure of the fees that Trustee would receive for managing the trust. The letter was in English. Though most of the factory employees did not speak English, their children could, and were able to translate most of the terms of the letter. The employees were overjoyed that their children would be able to go to college.

One of the children, Accountant, went to college and received his degree in accounting. Several years later, when the trust ran out of money, he investigated the amount of money the trust originally contained, and the amount of children who had benefitted from the trust. Upon reviewing a copy of the original letter that was sent to his parents which disclosed the amount of fees Trustee would receive, Accountant realized that approximately 3–5 more children would have been able to go to school if Trustee had charged slightly less fees.

Accountant knew that Trustee should not only be compensated for its services in managing the trust, but should also make a profit from its services. However, Accountant wondered if Trustee had any duty to ensure that the maximum amount of children were able to go to college via the trust fund. Accountant made this inquiry with his friend, Attorney, and asked if there might be a potential claim against Trustee for charging unreasonable fees that kept 3–5 students from receiving college scholarships. Attorney stated that as long as Trustee disclosed the amount of compensation it was receiving, no judge would question if that compensation was unreasonable. It did not matter that most of the disclosures were made in English to people who did not understand English, because it was their responsibility to ascertain meaning from the disclosure. Attorney explained that Trustee had a fiduciary duty to

132. *Id.*
133. *Id*. at 632–33.

the beneficiaries of the Trust, and that meant Trustee had to make full disclosure and refrain from engaging in trickery. Since Trustee did that, there was no reason to investigate the reasonableness of Trustee's fees to determine if it should have charged less so that a few more students would have received college scholarships.

In the above hypothetical, the situation that the beneficiaries found themselves in is comparable to the situation that many mutual fund investors face.[134] A *Forbes* study noted that, in general, investors do not comprehend the effect that fund expenses (like the adviser's compensation) have on their returns.[135] While advisers may make full disclosure regarding the amount of compensation they receive (like the Trustee made full disclosure to the employees), that does not mean that investors can ascertain meaning from those disclosures.[136] Because many investors have difficulties comprehending the effect that advisers' fees have on their returns,[137] the *Gartenberg* test was appropriate because it held advisers accountable for taking advantage of the investors by charging exorbitant, disproportionately large fees. In contrast, *Jones* removes the protection investors had by giving advisers the ability to make full disclosures that are also complicated and incomprehensible to the average investor. For this reason, the *Jones* court was wrong to disapprove *Gartenberg*.

In addition, even when investors are given straightforward figures, they often lack the financial acumen needed to calculate the effect those figures have on their returns.[138] For example, in the *Gartenberg* case, the adviser's fees amounted to $2.88 per year for every $1000 invested.[139] To most investors, that amount does not seem troubling.[140] Likewise, compensation that is disclosed in percentage terms often seems reasonable because of the low percentage rates. In *Jones*, the adviser's compensation ranged from 0.65% to 1%.[141] When investors see such low percentages, it hardly appears that their advisers are taking unfair portions of their investments because the investors lack the knowledge and skills necessary to analyze the effects of those fees. The *Gartenberg* test was appropriate because it recognized that mere disclosure was not enough to protect the average investor, and therefore

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134. James D. Cox & John W. Payne, *Mutual Fund Expense Disclosures: A Behavioral Perspective*, 83 WASH. U. L. Q. 907, 909–10 (2005).
135. *Id.*
136. *Id.*
137. *Id.*
138. *Id.*
139. Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 694 F.2d 923, 929 (2d Cir. 1982).
140. *Id.*
141. Jones v. Harris Assocs., L.P., No. 04 C 8305, 2007 WL 627640 at *2 (N.D. Ill. Feb. 27, 2007).

advisers not only had to a duty to make full disclosure but also to refrain from charging excessive, unreasonable fees.[142] The *Jones* decision removed that duty from the advisers, while simultaneously removing the protection *Gartenberg* provided the investors.

Finally, Judge Easterbrook's opinion likened adviser/investor relationships to attorney/client relationships.[143] He stated that though attorneys have fiduciary duties to their clients, courts do not analyze fee arrangements between attorneys and their clients to see if they are reasonable.[144] Rather, "the question a court will ask, if the fee is contested, is whether the client made a voluntary choice *ex ante* with the benefit of adequate information."[145] This is an incorrect statement of the law.[146] For example, Rule 1.5 of the Illinois Supreme Court Rules of Professional Conduct states that "[a] lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses."[147] Rule 1.5 lists eight factors a court should use in determining if a fee is reasonable.[148]

Whether one is a trustee, an attorney, or a CEO of a major corporation, fulfilling one's fiduciary duty requires more than mere disclosure. Reasonableness is also a necessary requirement. The act of mere disclosure is an inadequate method of measuring the fulfillment of the adviser's fiduciary duty because advisers are in a unique position of control. That unique position is traced to the ability of the advisers to speak a language that many investors do not fully understand, which is precisely the reason that many investors seek professionally-advised investment opportunities in the first place.[149]

B. Investment Advisers are in a Unique Position of Control

The *Jones* decision fails to recognize the exceptional circumstances under which advisers collect fees from the mutual funds. In 1935, when the SEC conducted a study of investment companies, they found "fantastic abuses of trust by management," as well as "wholesale victimizing of wholesale investment company security holders."[150] The victimization of investors was

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142. *Gartenberg,* 694 F.2d at 928.
143. Jones v. Harris Assocs., L.P., 527 F.3d 627, 633 (7th Cir. 2008).
144. *Id.*
145. *Id.*
146. *See, e.g.,* MODEL RULES OF PROF'L CONDUCT R. 1.5.
147. ILLINOIS S. CT. RULES OF PROF'L CONDUCT, RPC R. 1.5.
148. *Id.*
149. Cox & Payne, *supra* note 134, at 910–11.
150. *The Investment Company Act of 1940*, 50 YALE L.J. 440, 441–42 (1941) (citing *Hearings Before a Subcommittee of the Senate Committee on Banking and Currency on S.* 3580, 76th Cong., 3d Sess. (1940) Pt. I, p. 34; Pt. II, p. 783.)

the direct result of the investment companies making decisions with little regard for the benefits investors expected to receive, as well as cryptic disclosures regarding the control of the investment companies.[151] Congress acknowledged these abuses, as well as the unique positions of control that allowed the abuses to occur when it enacted the Investment Company Act of 1940.[152]

Most importantly, Congress realized that advisers held an extraordinary amount of control regarding their compensation from the mutual funds, and that was why the fiduciary duty was imposed in section 36(b).[153] The fiduciary duty specifically applied to the amount of compensation that advisers received from mutual funds.[154] Here, Congress recognized that as mutual funds grew in size, the advisers (and not the investors) were benefitting from the economy of scale.[155] While more investors added money to the mutual fund, and it increased in wealth, the advisers did not have additional costs.[156] However, if the advisers did not decrease their fees as the fund grew in size, their compensation would increase, without additional associated operating costs.[157] Unlike *Gartenberg*, the *Jones* decision fails to recognize that a breach of 36(b) may have occurred when the advisers' fees are disproportionately large in comparison to the services rendered.

There must be an incentive for investors to put their money into securities like mutual funds. When mutual fund advisers receive unreasonable rates of compensation, the funds' performance suffers.[158] Of course, the danger is that many investors are unable to ascertain the reason for the funds' poor performance, which is the power that advisers have over the investors.[159] The *Jones* decision ignored that power.

Mutual funds which yield disappointing results for investors, but at the same time earn high rates of compensation for advisers, continue to thrive upon the existence of two elements: (1) uninformed investors; and (2) the ability of financial professionals to profit from the investors' lack of knowledge.[160] Thus, it is no surprise when inadequate mutual funds continue

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151. *Id.*
152. *Id.*
153. *See* S. COMM. ON BANKING AND CURRENCY, INVESTMENT COMPANY AMENDMENTS ACT OF 1970, S. REP. NO. 91-184, at 1 (1969), *reprinted in* 1970 U.S.C.C.A.N 4897, 4899-4902.
154. Investment Company Act of 1940, § 36, 15 U.S.C. § 80a-35 (2006).
155. S. REP. NO. 91-184, at 4902.
156. *Id.*
157. *Id.*
158. Cox & Payne, *supra* note 134, at 909–11.
159. *Id.*
160. *Id*. at 910.

to attract unsuspecting investors.[161] Consequently, the fiduciary duty imposed on mutual fund advisers by section 36(b) of the Investment Company Act demonstrated Congress's awareness that investment advisers are in a unique position to control investors regarding the amount of compensation that they receive. The fiduciary duty of advisers, then, is not only to disclose their rates to uninformed investors, but to refrain from using their uniquely powerful position to receive unreasonable compensation. This was Congress's intent when imposing the fiduciary duty on advisers via section 36(b) of the Investment Company Act, but the *Jones* court was oblivious to that intent.

C. The Seventh Circuit's Decision Devoids Section 36(b) of Any Meaning

The Seventh Circuit was wrong in holding that mutual fund advisers may avoid breaching their fiduciary duties merely by making full disclosure of fees and refraining from engaging in trickery.[162] Regarding the meaning of fiduciary duty, the Seventh Circuit's opinion stated that when one examines the legislative history of section 36(b), there are "expressions that seem to support every possible position."[163] The opinion noted that some members of Congress appeared to support the view that a mutual fund adviser's fees must be reasonable, and equated charging reasonable fees with maintaining one's fiduciary duty.[164] Then the opinion stated that "the Senate Committee report disclaimed any link between fiduciary duty and reasonableness of fees" and supported that statement by specifically citing the *Gartenberg* opinion.[165]

However, upon reading the cited portion of the *Gartenberg* opinion, the Second Circuit reached no such conclusion.[166] The *Gartenberg* opinion did consider that bills including a reasonableness provision failed to pass through both houses of Congress.[167] Still, the Second Circuit noted that replacing "reasonable" for "fiduciary duty" appeared to be more of a "semantical than substantive compromise."[168] In addition, one of the chief sponsors of section 36(b), Congressman Moss, stated that "imposition of the fiduciary duty, would in effect require a standard of reasonableness in the charges."[169]

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161. *Id.*
162. Jones v. Harris Assocs., L.P., 527 F.3d 627, 630 (7th Cir. 2008).
163. *Id*. at 633.
164. *Id.*
165. *Id.*
166. Gartenberg v. Merrill Lynch Asset Mgmt., 694 F.2d 923, 928 (2d Cir. 1982).
167. *Id.*
168. *Id.*
169. *Id.* (citing 116 CONG. REC. 33281 (daily ed. Sept. 23, 1970)).

Thus, the *Gartenberg* decision correctly held that when determining if mutual fund advisers breached their fiduciary duty of section 36(b), all relevant information should be weighed.[170] An adviser violates section 36(b) if he charges a 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."[171] This definition is aligned with Judge Posner's dissent in *Jones*, as he noted that an unreasonable fee may be an indication of a breach of fiduciary duty.[172]

However, it was not necessary for the *Jones* court to grasp the meaning of 36(b) from the legislative history. Rather, Congress's intent is found in the plain meaning of the words used in the statute. For example, if Congress intended 36(b) to carry the meaning established by Judge Easterbrook's definition, the language of 36(b) would read something similar to "the investment adviser of a registered investment company shall make full disclosure to the investors and refrain from engaging in trickery with respect to the receipt of compensation for services." This definition would be useless, because if mutual fund advisers failed to make disclosures and/or engaged in trickery, the investors would have an action for fraud, and section 36(b) would be unnecessary.[173]

Instead, Congress used the words "the investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services" to describe a violation of 36(b).[174] The *Gartenberg* court accurately determined that while the fiduciary duty standard was a less-stringent modification of the reasonableness standard, there was still some room for reason when determining a violation of 36(b).[175] Because Judge Easterbrook asserts in his opinion that judges should not determine which fees are reasonable,[176] there is an important distinction to be made.

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170. *Id.* at 929.
171. *Id.* at 928.
172. Jones v. Harris Assocs., L.P., 537 F.3d 728, 732 (7th Cir. 2008).
173. *See* CHARLES ALAN WRIGHT & BRUCE BROMLEY, FEDERAL PRACTICE AND PROCEDURE § 1297 (5A 2008) (the elements of fraud are: (1) "defendant has made a false statement of or failed to disclose a material fact"; (2) "defendant has knowledge of . . . the falsity of the statement"; (3) "belief in the truth of the false statement . . . by the person to whom the representation is made"; (4) "intent on the part of the defendant that the statement or failure to disclose should be acted upon by the plaintiff"; and (5) "detrimental reliance upon the false representation or the fullness of the disclosure by the person claiming to have been deceived.")
174. Investment Company Act of 1940 § 36, 15 U.S.C. § 80a-35 (2006).
175. Gartenberg v. Merrill Lynch Asset Mgmt., 694 F.2d 923, 928 (2d Cir. 1982).
176. Jones v. Harris Assocs., L.P., 527 F.3d 627, 633 (7th Cir. 2008).

The *Jones* decision erroneously interpreted the *Gartenberg* decision as creating a judicially created standard of reasonable fees. The *Gartenberg* court correctly held that when considering all pertinent facts, an adviser will be guilty of violating 36(b) if there is *no* reasonable *relationship* to the services rendered and the fee charged.[177] This definition allows courts to determine if, after considering all factors, there is any connection between the services the adviser provided and how the adviser was compensated.[178] Certainly, one factor a court may consider is whether the adviser disclosed his fees. But that should not be the only factor. By enacting section 36(b), Congress imposed a fiduciary duty upon mutual fund advisers regarding compensation received; thirty years later, the *Jones* decision was wrong to narrow advisers' fiduciary duty to mere disclosure.

V. CONCLUSION

There are arguments for and against government regulation of the economy. The *Gartenberg* test gave mutual fund advisers the freedom to make a sizeable profit for their services, yet at the same time held them responsible for upholding a fiduciary duty to receive a profit that is not unreasonable under all of the circumstances. The *Gartenberg* test protected the investors by also protecting the advisers because it safeguarded the advisers' ability to make a profit while giving them guidelines to stay in compliance with section 36(b). The *Jones* opinion attempts to redefine fiduciary duty in a way that will only protect advisers and will encourage the return of the industry abuses that made section 36(b) necessary. The *Jones* decision was wrongly decided because a fiduciary must do more than simply make disclosures and refrain from engaging in trickery.

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177. *Gartenberg*, 694 F.2d at 928 (emphasis added).
178. *Id.*