

## Justifying *Jones*

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### INTRODUCTION

On March 30, 2010, the Supreme Court decided *Jones v Harris Associates*,<sup>1</sup> an appeal from an opinion written by Judge Frank Easterbrook.<sup>2</sup> Easterbrook has a remarkable record when the Supreme Court has reviewed his opinions, and the *Jones* decision was a rare rebuke. He is twice as likely to be affirmed as other courts of appeals judges—the Court has affirmed him nearly 65 percent of the time,<sup>3</sup> compared with an average of about 35 percent for all courts of appeals judges.<sup>4</sup>

One reason for Easterbrook's performance at the Court may be his judicial approach.<sup>5</sup> A major theme of Easterbrook's jurisprudence is fidelity to rules and a relatively narrow conception of the role of the court.<sup>6</sup> For instance, Easterbrook is regarded as a stickler for adhering closely to jurisdictional limitations on the power of courts and for resisting attempts by judges to short-circuit the Federal Rules of Civil

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<sup>1</sup> 130 S Ct 1418 (2010).

<sup>2</sup> *Jones v Harris Associates*, 527 F3d 627 (7th Cir 2008), vacd and remd, 130 S Ct 1418 (2010).

<sup>3</sup> The Court has affirmed ten Easterbrook opinions and reversed only five. Two were vacated and remanded.

<sup>4</sup> See Lee Epstein, William M. Landes, and Richard A. Posner, *Inferring the Winning Party in the Supreme Court from the Pattern of Questioning at Oral Argument*, 39 J Legal Stud \*6 (forthcoming 2010), online at <http://ssrn.com/abstract=1414317> (visited June 27, 2010). This result does not change if we compare Easterbrook with a subset of courts of appeals judges who have similar tenure and experience to Judge Easterbrook. A peer group of twelve courts of appeals judges (comprised of Judges Bruce Selya, Dennis Jacobs, Anthony Scirica, Harvie Wilkinson, Edith Jones, Danny Boggs, Richard Posner, Roger Wollman, Stephen Reinhardt, Deanell Tacha, Edward Carnes, and Douglas Ginsburg—one judge from every circuit) is affirmed by the Supreme Court just 34 percent of the time, compared with nearly 65 percent for Easterbrook. Overall, peer judges are reversed six times for every one thousand opinions they write, compared to just three times for Judge Easterbrook. Data on file with author.

<sup>5</sup> This may be, in part, because Easterbrook's approach aligns with the majority of the current Court, but his success stands out against his peer group, which is mostly composed of judges also appointed by President Ronald Reagan.

<sup>6</sup> See, for example, Frank H. Easterbrook, *Statutes' Domains*, 50 U Chi L Rev 533, 539–44, 552 (1983) (recommending a “meta-rule” of statutory construction that calls for “construction” only when the statute either explicitly addresses the issue before the court or instructs judges or administrators to find their own solution to the matter). See also generally David A. Strauss, *Statutes' Domains and Judges' Prerogatives*, 77 U Chi L Rev 1261 (2010).

Procedure. In *Vincent v City Colleges of Chicago*,<sup>7</sup> Easterbrook scolded a district court judge for granting a motion to dismiss based on the failure of the plaintiff to make certain factual allegations: “It is disappointing to see a federal district judge dismiss a complaint for failure to adhere to a fact-pleading model that federal practice abrogated almost 70 years ago.”<sup>8</sup> Easterbrook expressed sympathy for the district court’s desire “to get rid at the earliest opportunity of claims that do not seem likely to pan out,” but noted, “Rule 12(b)(6) does not serve this function.”<sup>9</sup> For Easterbrook, the rules are the rules, and notions of efficiency must yield to them.

This conservative view of the judiciary is a major theme of his jurisprudence, and it is evident in the recent decision involving Chicago’s gun ban and the question of whether the Second Amendment is incorporated against the states.<sup>10</sup> During oral argument, Judge Easterbrook expressed sympathy for the position of the National Rifle Association that the amendment be incorporated, but deferred to the Supreme Court, noting that such a decision is “above our grade level.”<sup>11</sup> Easterbrook explicitly refused to follow the Ninth Circuit, which effectively overruled the Supreme Court precedents on point,<sup>12</sup> noting that this “may be [their] attitude . . . but it’s not ours.”<sup>13</sup> There is some evidence that this difference in attitude matters: the Ninth Circuit has the worst track record at the Supreme Court among courts of appeals,<sup>14</sup>

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<sup>7</sup> 485 F3d 919 (7th Cir 2007).

<sup>8</sup> *Id.* at 924.

<sup>9</sup> *Id.*

<sup>10</sup> See *National Rifle Association of America, Inc v City of Chicago*, 567 F3d 856, 857 (7th Cir 2009), cert granted as *McDonald v City of Chicago*, 130 S Ct 48 (2009). See also generally Richard A. Epstein, *NRA v City of Chicago: Does the Second Amendment Bind Frank Easterbrook?*, 77 U Chi L Rev 997 (2010).

<sup>11</sup> Oral Argument, *National Rifle Association of America, Inc v City of Chicago*, Nos 08-4241, 08-4243, 08-4244, 00:04:08 (7th Cir May 26, 2009), online at <http://www.ca7.uscourts.gov/fdocs/docs.fwx?dname=arg> (visited Mar 17, 2010).

<sup>12</sup> See *Nordyke v King*, 563 F3d 439, 446–48, 457 n 16 (9th Cir 2009) (avoiding three Supreme Court precedents).

<sup>13</sup> Oral Argument, *National Rifle Association* at 00:11:13 (cited in note 11).

<sup>14</sup> During the 2008–2009 term, the Court reversed the Ninth Circuit in fifteen out of sixteen cases, or 94 percent of the time. See Carol J. Williams, *High Court Has Eye on 9th Circuit*, LA Times A3 (June 29, 2009) (noting that the Ninth Circuit has exceeded the average rate of reversal among the circuits in eight of the last ten years). This compares with an average of about 65 percent for all courts of appeals from 1946 to 2004. See Lee A. Epstein, et al, *The Supreme Court Compendium: Data, Decisions, & Developments* 244–45 (CQ 4th ed 2007) (providing data showing that the Supreme Court’s reversal rate between 1946 and 2004 was almost always between 50 and 75 percent). See also Richard A. Posner, *Is the Ninth Circuit Too Large? A Statistical Study of Judicial Quality*, 29 J Legal Stud 711, 713–14 (2000) (showing a statistically significant difference between the rate of summary reversals in the Ninth Circuit and other circuits between 1985 and 1997).

and its judge in the Easterbrook peer group, Judge Stephen Reinhardt, is thirteen times more likely to be reversed than Easterbrook.<sup>15</sup>

If *Jones v Harris Associates*<sup>16</sup> were an expression of Easterbrook's judicial conservatism, we might have thought it would survive Court review. But *Jones* is not about Easterbrook following the rules; in fact, it seems to be just the opposite. *Jones* rejects longstanding and well-established law regarding the compensation of mutual fund advisers in order to throw out cases earlier in the process in the name of economic efficiency. At first blush, it looks more Reinhardt than Easterbrook. We should not be surprised that Easterbrook, a pioneer of the law and economics movement, believes courts should try to apply economic theory to legal decisionmaking, but this tendency seems in tension with his rule-following instincts. *Jones* seems like a case in which Easterbrook's warm embrace of notice pleading (as seen in *Vincent*) was disregarded in favor of his economic theory about the pay of mutual fund advisers. But this is not exactly what was going on in *Jones*.

This Essay will show why *Jones* was consistent with both themes of Easterbrook's jurisprudence. The opinion deploys classic law and economics reasoning, relying on incentives and markets in ways other courts have not. But, I will argue, the opinion does not blatantly disregard the rules in the way Easterbrook accused the district court of doing in *Vincent*. The Court believed otherwise. It affirmed the *Gartenberg* standard Easterbrook rejected as representing "something of a consensus" among the lower courts and "correct in its basic formulation."<sup>17</sup> I will argue that this result, while not unreasonable, was not as desirable as the Court seems to believe nor was it necessary under existing Court precedents.

The statutory command Easterbrook interpreted in *Jones*—that advisers owe a fiduciary duty to investors with respect to pay—is not a rigid rule in the same way as Rule 12(b)(6) or diversity jurisdiction. To be sure, when asked to give meaning to "fiduciary," Easterbrook could simply have followed the precedents (from other circuits). But it is a rather cramped view of the judicial role to expect that broad standards, like the one in *Jones*, prevent courts from interpreting the words based on theoretical or practical considerations. This is especially true,

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<sup>15</sup> Reinhardt's reversal rate is about 4 out of every 100 opinions, and, conditional on certiorari being granted, prevails at the Court only 16 percent of the time. Data on file with author. Consider Matt Rees, *The Judge the Supreme Court Loves to Overturn*, *The Weekly Standard* (May 5, 1997), available online at <http://www.theweeklystandard.com/content/public/articles/000/000/001/414ilyss.asp> (visited Feb 24, 2010) ("Reinhardt has been heard to say, 'They can't catch 'em all.'").

<sup>16</sup> 527 F3d 627 (7th Cir 2008), vacd and remd, 130 S Ct 1418 (2010).

<sup>17</sup> *Jones*, 130 S Ct at 1425–26.

as we will see, because the interpretation Easterbrook gave was consistent with other usages of the same language. There was no reason to think Easterbrook was not following the rules when he applied the fiduciary law about how other agents are compensated to the question of how investment advisers are compensated, when all the statute says is that advisers are fiduciaries.

Judge Easterbrook's opinion also followed the rules about pleading, but not ones that he likes. At first, *Jones* seems at odds with the approach Easterbrook took in *Vincent*, since an effect of this approach is to promote a merits-collapsing approach similar to the one Easterbrook rejected there<sup>18</sup> and has consistently ridiculed as lawless.<sup>19</sup> But although Easterbrook does not acknowledge it, his decision in *Jones* follows directly from a Supreme Court precedent—*Bell Atlantic Corp v Twombly*<sup>20</sup>—issued three weeks after *Vincent*. In *Twombly*, the Court implicitly amended<sup>21</sup> the Federal Rules of Civil Procedure to permit courts to dispose of certain types of cases earlier in the litigation to avoid the expense of litigation and the frivolous cases higher costs create.<sup>22</sup> This Essay will use both theory and some back-of-the-envelope calculations of the costs of this type of litigation to show why *Jones* is one of those certain types of cases.<sup>23</sup> Despite Easterbrook's

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<sup>18</sup> See *Vincent*, 485 F3d at 923–24.

<sup>19</sup> See, for example, *Simpson v Nickel*, 450 F3d 303, 305 (7th Cir 2006) (remarking that the district court's treatment of the case "went wrong at the first step: the belief that complaints must lay out facts corresponding to every 'element' of a legal theory").

<sup>20</sup> 550 US 544 (2007).

<sup>21</sup> Precisely because the Supreme Court has the power to amend the Federal Rules of Civil Procedure pursuant to the Rules Enabling Act, Pub L No 73-415, 48 Stat 1064 (1934), codified as amended at 28 USC § 2072, it should not promulgate implicit amendments in the form of judicial opinions. To avoid this embarrassment, *Twombly*'s successor, *Ashcroft v Iqbal*, 129 S Ct 1937 (2009), claims to rely on the text of Rule 8(a)(2), which requires a "showing" that the plaintiff is entitled to relief. See *Iqbal*, 129 S Ct at 1949–50 (explaining that, while Rule 8 is a "notable and generous departure" from code pleading, it still requires the plaintiff to state more than mere legal conclusions). The claim would be that *Twombly* and *Iqbal* rejected prior Court precedents on Rule 8—for example, *Conley v Gibson*, 355 US 41, 45–46 (1957) (holding that courts should not dismiss complaints for failure to state a claim unless the plaintiff can prove that there exists "no set of facts in support of his claim which would entitle him to relief")—not as an implicit amendment of Rule 8 but because these precedents had not faithfully interpreted the pleading standard. Either way, the understanding of Rule 8 has changed.

<sup>22</sup> *Twombly*, 550 US at 558–59 (expressing concern about the high cost of discovery in antitrust cases, which could "push cost-conscious defendants to settle even anemic cases").

<sup>23</sup> The reach of *Twombly* was broadly asserted in *Iqbal*: "*Twombly* expounded the pleading standard for all civil actions and [ ] applies to antitrust and discrimination suits alike." *Iqbal*, 129 S Ct at 1953 (quotation marks and citation omitted). Nevertheless, commentators believe that the reach of these cases is not so broad, see, for example, Richard A. Epstein, *Bell Atlantic v. Twombly: How Motions to Dismiss Become (Disguised) Summary Judgments*, 25 Wash U J L & Pol 61, 81–82, 98–99 (2007), and there is considerable discretion in the lower courts to narrow the applicability of *Twombly* and *Iqbal* in practice to cases in which the rationale of early dismissal does not obtain.

fondness for notice pleading, the Court's new rules authorize lower courts to do exactly what Easterbrook did, whether or not it was his intention to do it.<sup>24</sup>

The boldness of *Jones* is made apparent by the fact that neither side in these mutual fund compensation cases supports the result Easterbrook reached.<sup>25</sup> This is highly unusual, and is especially odd considering that the opinion delivers what seems to be a generous gift to the mutual fund industry—an end to burdensome litigation. There are two reasons why no one defended *Jones*: agency costs between the lawyers and their clients, and a preference by the industry for the broken, but relatively benign, judicial review process over an unknown, but potentially scary, new law that might have come from Congress had the Supreme Court upheld *Jones*. This suggests that the Supreme Court did not hear the full story of this case and this class of disputes from the litigants; this Essay hopes to fill that gap.

### I. MUTUAL FUND FEE LITIGATION

In the cottage industry of mutual fund compensation cases, the dispute in *Jones* is about as vanilla as can be. Plaintiffs complained that the Oakmark Funds, which defendant Harris Associates started and then was hired to advise, were paying Harris too much for this work.<sup>26</sup> The law on point is § 36(b) of the Investment Company Act of 1940,<sup>27</sup> which makes fund advisers, like Harris, fiduciaries with respect to compensation received,<sup>28</sup> and *Gartenberg v Merrill Lynch Asset Management, Inc.*,<sup>29</sup> which established a multifactor test<sup>30</sup> for courts to

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<sup>24</sup> As such, the relevant Supreme Court precedents are not those about paying executives, for example, *Rogers v Hill*, 289 US 582, 591–92 (1933) (establishing the rule that minority stockholders can block bonus payments to executives when the level of compensation bears no relation to the value of the services provided), but rather the Court's recent civil procedure cases, *Twombly* and *Iqbal*.

<sup>25</sup> See Brief for Petitioners, *Jones v Harris Associates*, No 08-586, \*34–48 (US filed June 10, 2009) (available on Westlaw at 2009 WL 1640018) (arguing that the Seventh Circuit, by ignoring congressional intent and relevant common law principles, misinterpreted § 36(b)); Brief for Respondent, *Jones v Harris Associates*, No 08-586, \*26–32 (US filed Aug 27, 2009) (available on Westlaw at 2009 WL 2777652) (arguing for the Second Circuit's interpretation of "fiduciary duty" under § 36(b) and emphasizing the "extensive, varied, and context-sensitive" nature of fiduciary duties).

<sup>26</sup> See *Jones*, 527 F3d at 629–31.

<sup>27</sup> Investment Company Act of 1940, Pub L No 76-768, 54 Stat 789, codified at 15 USC § 80a-1 et seq.

<sup>28</sup> See Investment Company Amendments Act of 1970 § 20, Pub L No 91-547, 84 Stat 1413, 1429, amending 15 USC § 80a-35(b) ("[T]he investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services . . . paid by such registered investment company . . . to such investment adviser.").

<sup>29</sup> 694 F2d 923 (2d Cir 1982).

determine when pay was so great that it amounted to a breach of the § 36(b) duty.<sup>31</sup> Judges are not routinely in the business of adjudicating the fairness or efficiency of private compensation contracts, but the pay of mutual fund advisers may be different.<sup>32</sup>

Legal disputes about adviser compensation arise because of the unique governance structure of mutual funds. A sponsoring investment company creates each mutual fund as a separate legal entity. Each fund is managed by a board of directors, which is appointed by the sponsor of the fund. The fund, acting through the board, then chooses an adviser who will raise money, make investments, and then manage those investments. The board virtually always chooses the sponsor as adviser, and, as a practical matter, never replaces the adviser. Funds that perform badly are closed; they do not get new management. The potential governance problem here should be obvious—the board is supposed to negotiate a compensation schedule with the adviser, but the adviser is rarely, if ever, fired,<sup>33</sup> and it is the adviser (when acting as sponsor) that appointed the board in the first place.

The law does two things to try to solve this problem. The first is to require that the board of directors be composed of a certain percentage of “independent” directors.<sup>34</sup> They are designed to be, and think of themselves as, watchdogs for the interests of investors.<sup>35</sup> This is an attempt to put meaning in the fact that funds are legal entities separate from the advisers that create, and ultimately advise, them. Independent directors are thought to owe their allegiance to the fund, not to the sponsor or its adviser, and could be sued by investors in the fund if

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<sup>30</sup> Question: Why do lawyers love multifactor tests? Answer: They generate uncertainty, which generates disputes, which in turn generate fees.

<sup>31</sup> According to the district court in *Jones*, these factors include:

the cost to the adviser to provide services to the fund; the nature and quality of the services that are provided, including the fund’s performance history; whether and to what extent the adviser realizes economies of scale as the fund’s assets increase; the volume of orders from the fund’s investors that need to be processed . . . ; and the conduct of, expertise of, and level of information possessed by the trustees charged with approving the fee at the outset.

*Jones v Harris Associates*, 2007 WL 627640, \*7 (ND Ill) (accepting and applying the *Gartenberg* test).

<sup>32</sup> The analogy between the compensation of executives of business corporations and the advisers of mutual funds is extremely weak. See Donald C. Langevoort, *Private Litigation to Enforce Fiduciary Duties in Mutual Funds: Derivative Suits, Disinterested Directors, and the Ideology of Investor Sovereignty*, 83 Wash U L Q 1017, 1031–32 (2005).

<sup>33</sup> See *Jones*, 527 F3d at 634 (“Mutual funds rarely fire their investment advisers.”); Lyman Johnson, *A Fresh Look at Director “Independence”: Mutual Fund Fee Litigation and Gartenberg at Twenty-five*, 61 Vand L Rev 497, 519 & n 134 (2008) (citing a study that found only a handful of cases in which a primary mutual fund adviser was fired).

<sup>34</sup> At the time of the *Jones* suit, the law required 40 percent of the board to not be “interested persons” as defined by the Investment Company Act. See 15 USC §§ 80a-2(19), 80a-10, 80a-15(c).

<sup>35</sup> Based on ten confidential telephone interviews conducted with board members of ten different mutual fund companies during September and October 2009.

they violate this duty.<sup>36</sup> But practice may deviate from theory here. Even perfectly independent board members may be less vigorous than desired at negotiating against the people to whom they owe their jobs and with whom they interact on a regular basis. In order to provide extra incentives for arm's length bargaining, there is a second requirement: § 36(b) requires that the investment adviser assume the status of a fiduciary of the fund and its investors with respect to compensation received for its services.<sup>37</sup>

*Jones* was not the first case brought under § 36(b) alleging a breach of this duty. Since the fiduciary duty was mandated in 1970, there have been more than one hundred cases in which investors have sued investment advisers claiming a breach of the fiduciary duty with respect to compensation.<sup>38</sup> Defendants have “won” every case, meaning a court has never held that a mutual fund adviser violated its § 36(b) fiduciary duties.<sup>39</sup> *Jones* was no exception. The district court granted Harris's motion for summary judgment based on *Gartenberg*, rejecting the plaintiffs' argument that Harris's practice of charging a lower rate for institutional investors than for individual investors proved that the latter fees were too high.<sup>40</sup> The court concluded that the fees charged were not so disproportionate to the value received that they amounted to a breach of the fiduciary duty.<sup>41</sup>

Although Judge Easterbrook approved of the district court's result—that Harris's fees were not a breach of its fiduciary duty—he disagreed with its' reliance on *Gartenberg* and the judicial inquiry

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<sup>36</sup> The Supreme Court has referred to independent directors as “watchdogs” charged with the “primary responsibility for looking after the interests of the funds' shareholders.” *Burks v Lasker*, 441 US 471, 484–85 (1979). See also Johnson, 61 Vand L Rev at 502–05 (cited in note 33) (explaining that the management structure of investment funds creates a conflict between independent directors who, in their role as “watchdogs” of investor interests, owe a duty of loyalty to investors, and the advisers and sponsors of the fund, who control the assets and appoint directors to the board); Sarah E. Cogan, Philip L. Kirstein, and Audrey C. Talley, *The Fund Board of Directors and the Fund's Relationship with the Adviser*, 1744 PLI–Corp 195, 225–26 (2009) (explaining that, in addition to the regulations of the Investor Company Act of 1940, “fund directors are subject to traditional standards of director responsibility under common law and state statutes”).

<sup>37</sup> See 15 USC § 80a-35(b) (“[T]he investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services.”).

<sup>38</sup> See Johnson, 61 Vand L Rev at 519–20, 537–42 (cited in note 33) (discussing and listing the 150 reported cases that have cited to *Gartenberg* since 1982).

<sup>39</sup> See James D. Cox and John W. Payne, *Mutual Fund Expense Disclosures: A Behavioral Perspective*, 83 Wash U L Q 907, 923 (2005) (noting that plaintiffs have yet to win a case despite the “procedural ease” of bringing an action under § 36(b)). See also John P. Freeman and Stewart L. Brown, *Mutual Fund Advisory Fees: The Cost of Conflicts of Interest*, 26 J Corp L 609, 644 (2001) (“[N]o plaintiff has yet met the *Gartenberg* burden of proving that fees extracted from a given fund are ‘unreasonably unreasonable.’”).

<sup>40</sup> *Jones*, 2007 WL 627640 at \*7–9.

<sup>41</sup> *Id* at \*9.

(read: costs) it begets.<sup>42</sup> Judge Easterbrook intended *Jones* to do more than simply declare a winner in the litigation between Jones and Harris—he wanted to declare an end to § 36(b) litigation altogether, or, at least, the kind brought by private plaintiffs up to that point. He wanted to put district courts out of the business of weighing the *Gartenberg* factors because that inquiry is very costly,<sup>43</sup> the results of the inquiry are predetermined,<sup>44</sup> and the existence of the inquiry does nothing to deter the kinds of abuse the statute was designed to prevent.<sup>45</sup> Easterbrook’s opinion deploys a theoretical claim about markets and a plausible reading of the statute, but there is another unwritten factor driving his conclusion.

The theory is based on the fact that investing is voluntary and in open-ended funds, like Harris’s, investors can withdraw their money at any time at market value. So long as some investment decisions by some investors are somewhat rational (that is, made based on the value received),<sup>46</sup> advisers are prevented from charging excessively high fees, even where governance constraints are imperfect. There are more than eight thousand funds competing heavily to attract nearly \$16 trillion in investment dollars; Easterbrook doubts whether courts and their costly process can add much to this market for setting fees.<sup>47</sup> This is consistent with the longstanding practice of courts addressing issues of executive compensation. In the absence of obvious conflicts of interest or egregious failures of the pay-setting process, courts rarely, if ever, substitute their judgments for those of the market.<sup>48</sup> Everyone

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<sup>42</sup> See *Jones*, 527 F3d at 631–32 (criticizing *Gartenberg* for “rel[ying] too little on markets”).

<sup>43</sup> See Part II.B.

<sup>44</sup> See note 39 and accompanying text.

<sup>45</sup> See Part II.C. See also *Jones*, 527 F3d at 634 (arguing that judicial assessment of reasonableness misses the mark because the key question is not whether adviser fees are excessive “in the abstract,” but whether they are too high with respect to the results available from other investment vehicles—a question that investors are better suited than judges to answer).

<sup>46</sup> Metrics commonly deployed in analysis of the industry, such as net asset value (NAV) returns, may be misleading since they do not capture all of the potential value that may be received by investors. See John Morley and Quinn Curtis, *Exit, Voice and Fee Liability in Mutual Funds*, 120 Yale L J \*3 (forthcoming 2010), online at <http://ssrn.com/abstract=1547162> (visited Mar 17, 2010) (observing that NAV ignores expectation of future fees or portfolio changes, so funds with different expected future returns could have the same NAV); D. Bruce Johnsen, *Myths about Mutual Fund Fees: Economic Insights on Jones v. Harris* \*60 (George Mason University Law and Economics Research Paper No 09-49, Sept 2009), online at [http://works.bepress.com/d\\_bruce\\_johnsen/3](http://works.bepress.com/d_bruce_johnsen/3) (visited Sept 3, 2010) (arguing that mutual fund returns do not properly account for “the benefits from quality assurance in terms of monitoring costs avoided” that investors in certain funds actually realize). For an overview of fund performance analysis, see generally Ravi Shukla and Charles Trzcinka, *Performance Measurement of Managed Portfolios*, 1 Fin Markets, Institutions & Instruments No 4 (1992).

<sup>47</sup> See *Jones*, 527 F3d at 634.

<sup>48</sup> See D.A. Jeremy Telman, *The Business Judgment Rule, Disclosure, and Executive Compensation*, 81 Tulane L Rev 829, 831–33 (2007) (describing the business judgment rule as ubiquitous).

admits that the process for setting executive compensation is imperfect and results in some egregious compensation packages (when judged *ex post*), but courts applying fiduciary duty analysis are quite cautious about substituting their judgment for that of the (imperfect) market.<sup>49</sup> The market for mutual funds is mature and competitive, so it strains credulity to claim that advisers can get away with charging supra-competitive fees, let alone to contend that courts are equipped to efficiently police abuses.

Critics say the market for adviser fees is imperfect, and some recent empirical scholarship suggests there may be some investors who pay too much for what they are getting.<sup>50</sup> While these studies are interesting and bring important attention to the question of securities markets participation by unsophisticated investors, this result should hardly be surprising. In every market, whether it is for cars, legal services, or haircuts, some people pay more than they should for what they are getting. Smart businesses look for less-price-sensitive customers, and, where they can, charge them more than they charge more sophisticated shoppers. Other than a few statutory exceptions not applicable to mutual funds,<sup>51</sup> courts are not involved in remedying price discrimination. This is because the relevant question is not whether the market works perfectly, but whether a judicial inquiry will make it better than it would be without such an inquiry. It may be, for instance, that those who are paying more are getting more, but what they are getting may be invisible to the judicial eye. Unsophisticated investors may pay more for their investments because they do not have the time or skills to monitor the investments as well as sophisticated investors. These extra fees might be a sort of quality assurance mechanism that compensates managers who credibly commit not to cheat the investors who cannot monitor as well as more sophisticated investors.

A response to this line of argument is to point to § 36(b) as evidence that Congress wanted courts involved—a variant of the classic go-talk-to-

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ous in corporate law jurisprudence and arguing that courts should conceptualize the rule as an abstention doctrine rather than as an evidentiary guideline or a standard of review).

<sup>49</sup> See, for example, *In re Walt Disney Co Derivative Litigation*, 906 A2d 27, 55–60, 70–73 (Del 2006) (refusing to review the pay of Disney executives).

<sup>50</sup> See, for example, Javier Gil-Bazo and Pablo Ruiz-Verdú, *The Relation between Price and Performance in the Mutual Fund Industry*, 64 J Fin 2153, 2158–65 (2009) (demonstrating a negative relationship between mutual fund fees and the before-fee risk-adjusted performance of the funds).

<sup>51</sup> See, for example, Act of June 19, 1936 (“Robinson-Patman Act”), Pub L No 74-692, 49 Stat 1526, codified at 15 USC § 13 (making it unlawful to “discriminate in price between different purchasers of commodities of like grade and quality” when the effect of such discrimination is to harm competition); Act of August 15, 1921 (“Packers and Stockyards Act”) § 202(b), Pub L No 67-51, 42 Stat 159, 161, codified as amended at 7 USC § 192(b) (making it unlawful for any meatpacker to give unreasonable preference or advantage—or unreasonable prejudice or disadvantage—to any person or locality in any manner whatsoever).

the-legislature defense of objectionable statutes. Easterbrook, however, sees the statutory command to be a fiduciary not as empowering courts to be rate regulators, but rather to impose obligations of trust on the advisers.<sup>52</sup> Drawing on the law of trusts, from which fiduciary duties arise, Easterbrook notes that being a fiduciary means nothing more than being honest and forthcoming; it does not mean agreeing to a cap on the amount that can be charged.<sup>53</sup> After all, lawyers, brokers, trustees, and CEOs are all fiduciaries, and there are no limits on what they can charge, assuming they are truthful and play no games.<sup>54</sup>

Delaware's treatment of corporate manager pay is instructive. CEOs are fiduciaries of their shareholders, and yet courts do not inquire into whether their pay is "excessive" absent a gross conflict of interest (for example, self-dealing) or an abysmal failure of process.<sup>55</sup> Cases alleging too much pay in Delaware must allege a breach of the duty of care (insufficient process), a breach of the duty of loyalty (a conflicted board), or that the pay was so extreme as to suggest a failure of process or a hidden conflict.<sup>56</sup> In addition, the demand requirement in derivative litigation means plaintiffs must generally overcome procedural hurdles, such as showing that the board is conflicted or

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<sup>52</sup> See *Jones*, 527 F3d at 632.

<sup>53</sup> *Id.*

<sup>54</sup> For some, Easterbrook's reading of the statutory term "fiduciary" as requiring more than a claim of high fees will be enough to justify the result he reaches. *Twombly* and *Iqbal* have nothing to say about the antecedent legal question of whether the statute forbids unreasonable fees in the first place. That question presents a pure matter of statutory interpretation. In performing that interpretation, Easterbrook's approach is in keeping with his familiar, rule-based proclivities. For those who see "fiduciary," especially in this context, as being about something more, *Twombly* and *Iqbal* come into play as to the question of whether plaintiffs have mustered enough factual content to allow for a plausible finding that the fee was unreasonably high. Or, more specifically, whether any plaintiffs will be able to do so in a way that justifies the various costs of the judicial inquiry.

<sup>55</sup> See *Brehm v Eisner*, 746 A2d 244, 263 (Del 2000) (stating that executive compensation decisions are "entitled to great deference" and will be upset only if an agreement amounts to "an exchange that is so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration") (citation omitted). See also *In re Citigroup Inc Shareholder Derivative Litigation*, 964 A2d 106, 136 (Del Ch 2009).

<sup>56</sup> See *Brehm*, 746 A2d at 256, 262–64. Plaintiffs seldom overcome these stringent pleading requirements in executive compensation cases, see Randall S. Thomas and Kenneth J. Martin, *Litigating Challenges to Executive Pay: An Exercise in Futility?*, 79 Wash U L Q 569, 578 (2001) (explaining that few plaintiffs are able to show that the defendants "committed waste, that is, failed [their] substantive due care obligations by making an irrational decision"), but in a recent Delaware Chancery decision, the shareholders managed to defeat a motion to dismiss on a claim for waste, see *Citigroup*, 964 A2d at 138 (concluding that the plaintiffs stated a cognizable claim for corporate waste in their allegations stemming from the CEO's agreement paying him \$68 million in cash and stock despite his alleged responsibility for billions of dollars of losses at Citigroup). Though it is not yet clear whether *Citigroup* represents a change in the courts' willingness to review executive pay, I believe the case falls into the "so extreme" category and does not represent an inflection point in the law.

self-dealing, before a case can proceed to discovery.<sup>57</sup> Courts in Delaware simply throw out cases that baldly assert too much pay, thereby imposing no significant costs on defendants.

Easterbrook's interpretation of the statute also seems reasonable in light of the likely congressional purpose in choosing an ambiguous and flexible statutory term, like "fiduciary," instead of a more rigid command. Easterbrook interprets § 36(b) as delegating to courts the authority to determine the nature of the "fiduciary duty" inquiry based on market and other factors.<sup>58</sup> Instead of saying that pay must be "reasonable" or is capped at a certain level or subject to a certain type of review, the statute punted this question to judges in the future. It might be that in a market in which there is very little competition (say, because there are few funds or limited flows in and out of funds) determining whether there has been a breach of fiduciary duty might justify a robust judicial inquiry, while in a market with robust competition it would justify a hands-off approach. This choice fairly represents the natural evolution of the mutual fund market since § 36(b) was passed, and it would take a heroic interpretation of the language of the statute to suggest that Congress meant to make a particular process unalterable by changes in the market.

Although not explicit in *Jones*, the efficiency of § 36(b) litigation was the ultimate question before the Supreme Court. Rule-loving Easterbrook does not analyze the costs and benefits of this type of litigation, but by making the cases much less profitable for plaintiffs' lawyers, it is reasonable to assume that he believes the costs dwarf any benefits. There is enough wiggle room in "fiduciary duty" to allow him to construe it broadly if he thinks the benefits exceed the costs, or narrowly if he thinks the opposite.

## II. THE COSTS AND BENEFITS OF FEE LITIGATION

Why would a judge reject a legal rule that had always resulted in victory for defendants? The result for Harris would have been the same (but cheaper<sup>59</sup>) had Easterbrook followed *Gartenberg*: the Supreme Court would not have granted certiorari, and the issue of ad-

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<sup>57</sup> See *Stone v Ritter*, 911 A2d 362, 366–67 (Del 2006):

[T]he right of a stockholder to prosecute a derivative suit is limited to situations where either the stockholder has demanded the directors pursue a corporate claim and the directors have wrongfully refused to do so, or where demand is excused because the [plaintiffs have shown that the] directors are incapable of making an impartial decision regarding whether to institute such litigation.

<sup>58</sup> *Jones*, 527 F3d at 632–34.

<sup>59</sup> Harris had to pay to defend its district court victory at the Supreme Court, which must have been an expensive undertaking.

viser pay would not have potentially been a political issue. So why did Easterbrook create a controversy, risk reversal, and impose substantial costs on Harris by writing the opinion he did?

#### A. The Futility of Litigation

The answer has to do with civil procedure and the ineffectiveness of federal courts at efficiently processing litigation. If litigation were not costly, Easterbrook would have presumably found the *Gartenberg* standard less objectionable.<sup>60</sup> Although defendants can be confident ex ante about prevailing against § 36(b) claims, this litigation is costly, and these costs attract plaintiffs (or, rather, their lawyers) who can promise to settle the case for less than these costs and allow the defendants to avoid the time, hassle, and reputation costs of litigation. Advisers likely fear the publicity and process of litigation (especially being deposed) more than anything, and therefore may be eager to settle, especially since they may be able to pass on some of the costs to investors.<sup>61</sup>

In this case, the district court decided for Harris only after summary judgment, at which point Harris had likely spent millions of dollars on discovery and lawyers.<sup>62</sup> To bless the district court's decision at this point would suggest that what the court did was correct, not only on the merits, but also in terms of the analysis and the timing of its decision. If decisions about pay are to be made at summary judgment (or after), this sets the value of any settlement much higher than if the same decisions can be made earlier in the litigation, especially before discovery. A simple affirmance of the district court might have been the victory Harris wanted, but it would have been a defeat for other funds and for investors, since it would have left open the possibility of future suits of this kind and encouraged those suits to go to the later stages of litigation necessary for courts to get the facts needed to apply the *Gartenberg* factors.

The suit in *Jones* was about rent extraction of these expected litigation costs from defendants. The probability of victory at trial for the plaintiffs was zero when they filed the case. No set of facts has ever resulted in liability against mutual fund investment advisers, and, as

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<sup>60</sup> Easterbrook might still believe that judicial resources could be better spent elsewhere.

<sup>61</sup> Defendants undoubtedly write the check for any settlement, but it is likely that fees generally increase to account for expected settlements. If litigation costs are somewhat random, the payment by a fund of a settlement should have no impact on the fund's ability to attract capital, especially since settlements are trivial in comparison to fund size and are confidential in any event. While defendants pay, investors ultimately bear the costs.

<sup>62</sup> See Part II.B. Consider *In re Cox Communications, Inc Shareholders Litigation*, 879 A2d 604, 640–42 (Del Ch 2005) (denying a request for \$4.95 million in legal fees by the plaintiffs' attorneys and awarding \$1.275 million following the settlement of a suit challenging whether directors had fulfilled their fiduciary obligations with respect to a merger agreement).

the district court opinion makes clear, the facts in *Jones* were unremarkable. Fees paid to Harris were standard in the industry, and there was no evidence of significant conflicts of interest, lack of disclosure, or other tricks that would generate judicial concern.<sup>63</sup> Importantly, the plaintiffs' best argument—that Harris was paid more to manage the accounts of individual investors than it was to manage the accounts of institutional investors—had been rejected by many other courts.<sup>64</sup> Putting aside the merits of this argument, the implausibility of this district court reaching a different conclusion than the numerous other courts that had considered precisely the same argument in the exact same context and rejected it absolutely as a legal matter means the case was a sure loser. And yet, there it was, imposing costs on Harris, using judicial resources, and diverting plaintiffs and their lawyers from more meaningful pursuits.

The problem of strike suits and the incentives created by inefficient litigation is more acute in federal than in state courts on these issues,<sup>65</sup> and hence may justify the kind of procedural intervention in *Jones*. In federal courts, where litigating the reasonableness of pay is costly, plaintiffs can extract larger settlements than they can in state courts, like Delaware, where the costs are nearly zero.<sup>66</sup> As a result, we see a similar legal standard—a fiduciary duty with a limit on excessive

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<sup>63</sup> *Jones v Harris Associates*, 2007 WL 627640, \*8 (ND Ill).

<sup>64</sup> See, for example, *In re Evergreen Mutual Funds Fee Litigation*, 240 FRD 115, 122 (SDNY 2007) (“[S]uch comparisons are not necessarily informative when assessing whether fees are disproportionate to the services rendered.”). See also *Strougo v BEA Associates*, 188 F Supp 2d 373, 384 (SDNY 2002) (dismissing a § 36(b) action despite evidence that the investment adviser received less in fees from its institutional clients, because the “relevant comparison must be to other mutual funds, not to non-mutual fund institutional clients”); *Schuyt v Rowe Price Prime Reserve Fund, Inc.*, 663 F Supp 962, 973 n 38 (SDNY 1987) (rejecting the plaintiffs’ expert analysis, which compared the fees that the adviser charged the fund with fees the adviser charged other, non-mutual fund entities), *affd*, 835 F2d 45 (2d Cir 1987). But see *Gallus v Ameriprise Financial, Inc.*, 561 F3d 816, 823–24 (8th Cir 2009) (finding error in the district court’s refusal to compare the fees charged to institutional clients with those charged to mutual fund clients).

<sup>65</sup> See text accompanying notes 99–101.

<sup>66</sup> *Id.* Since the Federal Rules of Civil Procedure have no analogue to Delaware’s demand requirement, the federal system lacks an effective mechanism for screening out frivolous shareholder suits prior to discovery. Consider *Blue Chip Stamps v Manor Drug Stores*, 421 US 723, 741–43 (1975) (explaining that in securities cases, even unfounded claims “ha[ve] settlement value to the plaintiff . . . because of the threat of extensive discovery and disruption of normal business activities which may accompany a lawsuit which is groundless in any event, but cannot be proved so before trial”); Robert B. Thompson and Randall S. Thomas, *The Public and Private Faces of Derivative Lawsuits*, 57 Vand L Rev 1747, 1749, 1759–60 (2004) (noting that only about thirty shareholder derivative actions are brought in Delaware each year and attributing the low rate in part to Delaware’s demand requirement, which essentially requires plaintiffs to allege demand futility while simultaneously preventing them from using discovery to obtain information that would support their allegation).

compensation<sup>67</sup>—generating hundreds and hundreds of federal cases and few if any state law cases.<sup>68</sup> This despite the fact that, as Judge Richard Posner hints in his dissent from the Seventh Circuit’s denial of rehearing en banc in *Jones*, there is as much or more evidence of failures in the executive compensation market as there is in the adviser compensation market.<sup>69</sup> From the fact that a similar legal standard generates many more cases in federal court than state court, we might conclude that there are different costs and benefits of compensation litigation across these jurisdictions. One might conclude that the § 36(b) duty as interpreted by courts to this point generates large costs without attendant benefits in part because of the inadequacy of federal courts in efficiently processing claims. To show this, however, requires an analysis of the costs and benefits of § 36(b) cases.

## B. Costs

There are several costs of § 36(b) litigation that are readily apparent. Most obviously, there are the actual legal costs of prosecuting and defending these suits. Other costs include: the distraction that litigation causes for advisers and boards; the negative consequences of

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<sup>67</sup> In state courts, the standard is whether the pay was so excessive as to constitute a “waste” of corporate assets, see *In re Citigroup Inc Shareholder Derivative Litigation*, 964 A2d 106, 136 (Del Ch 2009) (clarifying that, to assert a waste claim successfully, a plaintiff “must overcome the general presumption of good faith by showing that the board’s decision was so egregious or irrational that it could not have been based on a valid assessment of the corporation’s best interests”) (citation omitted), while in federal courts it is whether the adviser pay is “so disproportionately large that it bears no reasonable relationship to the services rendered,” see *Gartenberg*, 694 F2d at 928. In both cases, the core underlying concern is whether the pay can reasonably be said to be the result of arm’s length bargaining.

<sup>68</sup> The leading study on state law pay litigation finds just 124 cases from 1912 to 2000 in all states. See Thomas and Martin, 79 Wash U L Q at 573–74 (cited in note 56) (gathering all cases available from the Lexis and Westlaw databases dealing with the process, size, or composition of executive compensation). The study finds that there are very few cases in this nearly ninety-year period in which there were bald allegations of too much pay without corresponding claims of process failures or conflicts of interest. *Id.* at 578–79. In addition, it finds that claims are much more likely to be brought and to succeed against private firms, where the risk of expropriation from minority shareholders is much higher than for public firms. *Id.* at 586–87. (Mutual funds are much more akin to publicly traded companies, since in a mutual fund there are no minority shareholders whose interests are frozen in the corporate form, as they may be in a privately held corporation.) These data fit with the perspective of experts in Delaware litigation that there are no cases filed in Delaware courts today in which plaintiffs allege simply that executives are paid too much without allegations of procedural irregularities or loyalty problems. Telephone interview with Charles Elson, Director of the John L. Weinberg Center for Corporate Governance, University of Delaware (Sept 3, 2009).

<sup>69</sup> *Jones v Harris Associates*, 537 F3d 728, 730–31 (7th Cir 2008) (Posner dissenting from denial of rehearing en banc) (citing a growing consensus that executive compensation in large public firms “often is excessive because of the feeble incentives of boards . . . to police compensation,” and arguing both that mutual funds suffer from similar problems and that market competition cannot be relied upon to solve these problems in either case).

making boards focus on regulatory matters and compliance when they could focus on business or strategy matters; and the potential false sense of security that the law gives investors.

We can get a rough idea of the (lower bound) cost of § 36(b) litigation by looking at the legal work involved in these cases. Although data is unavailable as to the specific costs, one need only look at *Jones* to see that the amounts are significant. Seventeen attorneys were involved in *Jones* at the district court, and they filed more than twenty motions or memoranda. So far the case has generated six court opinions.<sup>70</sup> The costs for Harris to defend the suit to this point are in the tens of millions of dollars, according to a lawyer familiar with the litigation.<sup>71</sup>

A look at the publicly available records of the legal work from a selection of 20 of the more than 150 reported cases involving § 36(b) claims under the *Gartenberg* standard provides a sense of the costs of this kind of litigation more generally.<sup>72</sup> The average case was on the judicial docket for more than two years, involved about a dozen lawyers, and generated more than ten orders from the courts. If we extrapolate the average of these cases to 150 cases (a rough estimate of the number of published § 36(b) opinions), we can get a sense of what was at stake for the entire mutual fund industry (as opposed to Harris) in *Jones*. Extrapolating from the sample of twenty cases, we can estimate that these cases involved approximately 1,400 lawyers filing nearly 1,000 motions and about 1,500 legal briefs, and generated more than 1,400 judicial orders. There are no data available on how much any of this costs, but it is undoubtedly significant, especially because the number of published cases must be dwarfed by the number of cases that are filed but settled before they generated written opinions.<sup>73</sup>

We can get a ballpark estimate of the total costs of § 36(b) litigation by making some reasonable assumptions based on information from industry experts and insiders. We know from Professor Lyman Johnson that there have been about 150 cases citing *Gartenberg* that

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<sup>70</sup> These figures are based on the author's analysis of court records. The six opinions are *Jones v Harris Associates*, 130 S Ct 1418 (2010), *Jones v Harris Associates*, 537 F3d 728 (7th Cir 2008); *Jones v Harris Associates*, 527 F3d 627 (7th Cir 2008); *Jones v Harris Associates*, 2007 WL 627640 (ND Ill); *Jones v Harris Associates*, 2006 WL 1005100 (ND Ill); *Jones v Harris Associates*, 2005 WL 831301 (ND Ill).

<sup>71</sup> Confidential telephone interview with a lawyer familiar with the litigation (Sept 29, 2009).

<sup>72</sup> The ensuing figures were calculated by examining the courts' records corresponding to the 150 reported § 36(b) cases identified by Professor Lyman Johnson. See Johnson, 61 Vand L Rev at 499–500 (cited in note 33). The 20 cases for which sufficient data were available were examined, and their results averaged. These averages were then multiplied by 150 to obtain the aggregate figures.

<sup>73</sup> See Thomas and Martin, 79 Wash U L Q at 574 n 20 (cited in note 56) (estimating that between 2 and 10 percent of all executive compensation challenges filed ever yield a judicial opinion).

have generated published opinions.<sup>74</sup> Taking a subset of these cases, Johnson finds about 60 percent of these were cases that were resolved prior to summary judgment and 40 percent at summary judgment or later.<sup>75</sup> If for the sake of simplicity we assume about a fifty-fifty split across all cases, we can get a very rough, ballpark estimate the costs of the litigation. One estimate from an industry insider is that taking a § 36(b) case to summary judgment costs defendants about \$20 million.<sup>76</sup> If we assume that the cases resolved at the motion to dismiss stage are much cheaper, say \$1 million, then we can get an estimate of the defendants' costs in these 150 cases over the past 27 years—about \$1.6 billion.<sup>77</sup>

In addition, a number of other cases settled before they could generate a written legal opinion.<sup>78</sup> One estimate from an industry expert is that each fund, of which there are about eight thousand today,<sup>79</sup> has about a 1 percent chance of being sued every year.<sup>80</sup> This generates about 80 cases per year, for a total of 2,160 cases since 1982. Since the number of funds has changed over time, however, this figure may overstate the total number of cases. To be conservative, we can estimate that about half that number, or about one thousand cases, have been settled since 1982. The cost of the average settlement must be less than the cost of going to summary judgment, so we can ballpark this at about half the cost of summary judgment, or about \$10 million for each settlement. A representative of the industry confirms that this is a reasonable estimate,<sup>81</sup> although no publicly available information exists. This means there is an additional cost of \$10 billion over the

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<sup>74</sup> See Johnson, 61 Vand L Rev at 499–500 (cited in note 33).

<sup>75</sup> See id at 519–20.

<sup>76</sup> Confidential telephone interview with a representative from a mutual fund industry trade group (Oct 9, 2009).

<sup>77</sup> This is calculated as: 75 cases × \$20 million plus 75 cases × \$1 million.

<sup>78</sup> For some recent settlements, see Order of Dismissal with Prejudice, *Vaughn v Putnam Investment Management, LLC*, Civil Action No 04-10988 (D Mass Mar 31, 2008); Stipulation of Dismissal with Prejudice, *Dumond v Massachusetts Financial Services Co*, Civil Action No 04-11458 (D Mass Nov 20, 2007); Stipulation of Dismissal, *Strigliabotti v Franklin Resources, Inc*, No C-04-0883 (ND Cal Aug 9, 2007); Notice of Dismissal, *Sins v Janus Capital Management, LLC*, No 04-cv-01647 (D Colo May 2, 2007); Memorandum and Order, *Hunt v Invesco Funds Group, Inc*, No 04-cv-2555 (SD Tex Jan 29, 2007); Stipulation of Dismissal with Prejudice, *Williams v Waddell & Reed Investment Management Co*, No 04-2561 (D Kan Sept 25, 2006). See also James N. Benedict, et al, *Recent Developments in Litigation Involving Mutual Funds and Investment Advisers*, 1732 PLI–Corp 943, 951 (2009).

<sup>79</sup> See *Jones*, 527 F3d at 633–34 (“By the end of 2002, over 8,000 mutual funds held more than \$6 trillion in assets.”).

<sup>80</sup> Confidential telephone interview with a representative from a mutual fund industry trade group (Oct 1, 2009).

<sup>81</sup> Id.

past 27 years.<sup>82</sup> The total cost for defendants to defend or settle these suits is therefore about \$11 billion.<sup>83</sup> This amounts to roughly \$400 million in costs per year for the industry as a whole.

This is a large amount in the aggregate, but amounts to only about \$50,000 per fund per year. As discussed further below,<sup>84</sup> if the average fund has assets of \$1.4 billion and a management fee of about 1 percent,<sup>85</sup> this means that the management fees are about \$14 million per year. Expected litigation costs of \$50,000 per year thus amount to a litigation tax of just 0.4 percent of revenue. This is therefore a case in which there are potentially large aggregate costs (about \$400 million per year) but very small private costs for each actor: hence the seed for justifying Judge Easterbrook considering the aggregate costs of § 36(b) litigation instead of just the interests of the parties.

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<sup>82</sup> If the percentage estimate applies to fund families, instead of funds, the total number of cases per year looks more like 5, since there are about 500 fund families. In that case, the total costs for these cases is about \$1.4 billion ( $5 \times \$10 \text{ million} \times 27$ ), giving a total cost of about \$3 billion since 1982 if we include the settled cases, see note 77 and accompanying text, or about \$200,000 per fund family per year.

<sup>83</sup> Plaintiffs have costs too, but these are likely trivial in comparison, since they involve only lawyers' fees, and do not include discovery costs, which are likely the biggest costs. See Tom Baker and Sean J. Griffith, *How Merits Matter: Directors' and Officers' Insurance and Securities Settlements*, 157 U Pa L Rev 755, 777 (2009) (noting that a document-discovery database can cost millions of dollars for some large cases, and that such costs "create an obvious and well-known incentive for defendants to settle"). See also John S. Beckerman, *Confronting Civil Discovery's Fatal Flaws*, 84 Minn L Rev 505, 543 (2000) (noting that discovery places a disproportionate burden on defendants because the plaintiff receives "not only all of the informational benefits from discovery, but also impositional benefits in the form of expenses imposed on the responder"); Frank H. Easterbrook, *Discovery as Abuse*, 69 BU L Rev 635, 643 (1989) (pointing out that discovery imposes "asymmetric costs"). If it costs plaintiffs \$1 million in legal fees to take a case to summary judgment, and just \$100,000 otherwise, the total costs for these cases are only about \$300 million over the twenty-seven-year period. We can therefore safely ignore them, since they are within a reasonable margin of error for these assumptions.

<sup>84</sup> See notes 92–94 and accompanying text.

<sup>85</sup> There are about \$11 trillion in assets under management, see Investment Company Institute, *Trends in Mutual Fund Investing: April 2010*, online at [http://www.ici.org/research/stats/trends/trends\\_04\\_10](http://www.ici.org/research/stats/trends/trends_04_10) (visited June 27, 2010), at about 8,000 funds, meaning the average fund has about \$1.4 billion in assets under management. One percent is the approximate management fee charged by defendant Harris Associates for the Oakmark Funds, which the parties and the court characterized as about average. See *Jones*, 2007 WL 627640 at \*1 (describing Oakmark's fee schedule, which required payment of a 1 percent fee on the first \$2 billion of the fund's assets); id at \*8 (observing that neither party disputes the fact that Oakmark's adviser fees were comparable to those of similar funds managed by other companies). See also SEC, Division of Investment Management, *Report on Mutual Fund Fees and Expenses* III.B.1, III.C.2 (Dec 2000), online at <http://www.sec.gov/news/studies/feestudy.htm> (visited Feb 28, 2010) (calculating an average expense ratio, which includes administrative in addition to adviser fees, of between 0.94 and 1.36 percent across all mutual funds in 1999).

### C. Benefits

Litigation has not only costs but also benefits, and we should encourage laws that generate disputes in which the latter generally outweigh the former. The only possible benefit of § 36(b) would be that funds are deterred from overcharging their investors because of the risk of litigation. In order to support *Gartenberg*, one would have to believe that without the right to sue under this standard, investment advisers would pay themselves more than they currently do, and that this amount exceeds the costs of the litigation. It is possible that an articulate and administrable rule punishing advisers *ex post* for wrongdoing could efficiently reduce the monitoring costs of unsophisticated investors, but there is no reason based on the experience to date to think that *Gartenberg* gets this right. By contrast, Easterbrook's rule seems to provide for punishment based on the worst type of abuses while minimizing the possibility that false positives<sup>86</sup> will impose large costs on investors.

The *Gartenberg* standard might have some deterrent effect if advisers believe suits under § 36(b) occur when funds charge fees that are relatively high or are otherwise unjustified by the performance of the fund. If advisers believe that charging higher fees will incur suits, this may deter them somewhat from charging those fees.<sup>87</sup> But if advisers believe that the chance of suit is independent of the fees they charge, then it will not deter overcharging as effectively, if at all. An unscientific but random sample of board members and industry insiders interviewed for this Essay suggests that board members believe suits under § 36(b) are not correlated with the rate of fees charged, the board process for setting those fees, nor whether the fees are "deserved" in some sense. Board members describe the chances of the adviser being sued in a § 36(b) case as "unrelated to the amount of fees paid," "the same no matter how much we negotiate or how much due diligence we do," "as random as being struck by lightning," and "related more to the size of the fund and whether a plaintiff can be found than anything to do with fees."<sup>88</sup> Whether or not these assertions are true, boards seem to think they are true, which undermines any deterrent effect that the law as implemented may provide.

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<sup>86</sup> See Part III.

<sup>87</sup> Bruce Johnsen claims that this entire inquiry is irrelevant, because if a fund lowers its fees, while holding performance constant, it should see a corresponding increase in the assets of the fund that perfectly offsets the drop in fees. See Johnsen, *Myths about Mutual Fund Fees* at \*45 (cited in note 46).

<sup>88</sup> Based on ten confidential telephone interviews conducted with board members of ten different mutual fund companies conducted during September and October 2009.

As mentioned above, there is some evidence that some (small) funds charge higher fees than their performance seems to warrant,<sup>89</sup> but according to industry observers and lawyers involved in these cases (on both sides), these are not the firms that get sued.<sup>90</sup> Plaintiffs' lawyers recognize that the *Gartenberg* standard is nearly impossible to meet, so the chance of being the first case to prevail at trial is very low. If this is true and the object of the suit is settlement, it makes much more sense to go after deep-pocketed defendants. This is especially true given that the amount of damages is capped at the amount of "excessive" fees paid in the prior year.<sup>91</sup> Since fees are based on a percentage of total assets, and it presumably costs the same to go after the adviser of a big fund as a small one, it makes sense, all else being equal, to target the big ones. One might argue that big funds will be more ably represented, but because settlements can be won with little or no consideration of the merits, the fact that the case against large funds might not be as good as that against smaller funds is irrelevant. Insofar as the merits are meaningless, the quality of lawyering should not be a major factor in the decision of whom to sue, especially since good lawyers presumably cost more than bad ones, which just raises the value of any settlement.

Not only are § 36(b) cases believed to be uncorrelated with the relative size of fees, but as a practical matter, the amount of deterrence from these cases is likely to be trivial given the relatively low stakes of the litigation compared to the size of the industry and the compensation of investment advisers. To see this, consider the Oakmark Funds managed by Harris. The funds had about \$5 billion in assets and management fees of about 1 percent of this amount, or \$50 million per year.<sup>92</sup> If plaintiffs were successful in their litigation, and were able to reduce Harris's fees to, say, 0.7 percent, the damages would be about \$15 million.<sup>93</sup> This means that for Harris to be deterred from charging "too much" (1 percent versus 0.7 percent), it must face an expected cost from litigation of more than \$15 million per year.<sup>94</sup>

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<sup>89</sup> See note 50 and accompanying text.

<sup>90</sup> Based on in-person interviews with lawyers and industry experts.

<sup>91</sup> See note 94.

<sup>92</sup> See *Jones*, 2007 WL 627640 at \*1. These figures have been rounded in order to simplify the calculations. Based on the fee schedule described by the district court, see *Jones*, 2007 WL 627640 at \*1, the management fee was 0.88 percent.

<sup>93</sup> That is, 1 percent minus 0.7 percent  $\times$  \$5 billion = \$15 million.

<sup>94</sup> Importantly, § 36(b) limits the amount of damages to the one-year period prior to filing suit. See § 36(b)(3) ("No award of damages shall be recoverable for any period prior to one year before the action was instituted."). Note that if litigation costs are expected to be less than \$15 million, Harris would pocket the "extra" \$15 million, pay the costs of litigation, and keep the (positive) difference.

But expected litigation costs are likely much less than \$15 million per year. The best available information suggests firms have about a 1 percent chance of suit in a given year,<sup>95</sup> meaning a suit would have to cost (either in damages, settlement costs, or litigation costs) more than \$1.5 billion in order for the fund to be deterred from charging “excessive” fees. But the statute limits damages to the excessive fees charged in the year prior to the suit, and, as such, this is impossible. Or, looking at it another way, if litigation fees are \$20 million to get to summary judgment, and the probability of being sued in any year is 1 percent, then the value of the deterrence is \$200,000 per year. If the fund has \$5 billion in assets under management, this would amount to a difference in fees of 0.004 percentage points (for example, 0.996 percent instead of 1 percent in fees). A final way of seeing this is to point out that if it costs \$15 million to settle a suit and the gains from excessive payments are about \$15 million per year, then to be deterred from overpaying, funds would have to face a 100 percent probability of suit every year.

This crude model shows that deterrence is a very weak basis for justifying the *Gartenberg* rule. To be sure, this analysis assumes a rather crude model in which the board and the adviser are functioning purely as a collective version of *Homo economicus*. The model does not describe the reality of actual board-adviser negotiations; rather it merely points out the incentives under which advisers and board members operate, whether they are cognizant of them or not.

Nevertheless, one could argue that § 36(b) has a deterrent effect because the independent directors of funds disregard the simple economics of the litigation threat, and instead want to do the right thing and take their fiduciary duties seriously. Without impugning board members or advisers, this description does not square with the view expressed by board members that suits are not correlated with the seriousness with which they take their jobs.<sup>96</sup> It also is inconsistent with a regime in which most cases settle privately—if advisers can avoid nonmonetary costs, such as negative publicity, being deposed, and so on, by paying to make suits go away, then any deterrence must be viewed in monetary terms.

There are two external constraints on the fees boards authorize and advisers accept—market forces in the form of attracting assets and the threat of litigation. If the latter is purely random, and the former is highly (but not perfectly) correlated with the payment of rea-

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<sup>95</sup> See note 80 and accompanying text.

<sup>96</sup> See note 88 and accompanying text.

sonable fees,<sup>97</sup> then the market forces constraint will dominate. If we relied solely on the litigation deterrent, the analysis returns to the financial incentives discussed above, and these would be plainly insufficient to reduce pay. When Easterbrook writes that the problem with *Gartenberg* is that it relies too little on market forces,<sup>98</sup> this is what he has in mind.

There may be some value in best-practices standards, like those found in *Gartenberg* or in a random (or, better yet, targeted) audit of funds. Under this theory, the *Gartenberg* test is important because it makes board members and advisers do work they would otherwise not do, and, even if suits are random, improves the terms of any settlement or the likelihood of prevailing at trial. Even if plausible, there is no reason to think that the current system of private enforcement of § 36(b) is the most efficient way of achieving this goal. The SEC and a variety of quasi-governmental agencies, such as those regulating brokers and other securities professionals, have several advantages over courts in deploying this type of soft regulation. First, as experts in this area, these agencies are likely better positioned to make judgments about the reasonableness of fees based on the latest empirical data and the state of the market as a whole. Second, government agencies presumably have less incentive to engage in strike suits, since the lawyers bringing the cases are not compensated in direct proportion to the size of any settlements. In other words, all else being equal, government prosecutors have stronger incentives to represent the plaintiffs who are most likely harmed by the current compensation scheme for fund advisers—that is, less sophisticated and less-price-sensitive investors in smaller funds.

The comparative advantage of the government as prosecutor here points to an answer to another puzzle about the case: why did the Supreme Court reinstate a standard that never results in victory for plaintiffs, is used by plaintiffs' lawyers to extract settlements from large and relatively well-paying funds, and is providing little or no de-

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<sup>97</sup> See Johnsen, *Myths about Mutual Fund Fees* at \*45 (cited in note 46) (“Holding investors’ expectations of manager stock picking skill and other factors constant between two funds, the fund with the lower fee will simply attract larger inflows in the process of equalizing investors’ returns with their best outside opportunity.”); John C. Coates, IV and R. Glenn Hubbard, *Competition in the Mutual Fund Industry: Evidence and Implications for Policy*, 33 J Corp L 151, 180, 183–84 (2007) (concluding on the basis of empirical evidence that “investors shift substantial amounts of assets out of high-fee funds and into low-fee funds,” bolstering the claim that fund competition “strongly constrains advisory fees”). See also Morley and Curtis, 120 Yale L J at \*2–4 (cited in note 46) (arguing that mutual fund investors who are unhappy with a fund’s performance will almost always redeem their shares and reinvest with a fund offering competitive fees and returns rather than exercise their shareholder rights or sue the fund).

<sup>98</sup> *Jones*, 527 F3d at 632.

terrent effects? One answer might be that the *Gartenberg* standard preserves the possibility that the government might someday bring a § 36(b) case. But the billions spent on (or, wasted on) private litigation to date seems like a fairly stiff price to pay for the remote future possibility of government action. In addition, the SEC could, through rulemaking, enforcement of existing rules on brokers, education of investors, jawboning, or other means, try to influence the behavior of fund advisers or investors in funds allegedly charging excessive fees. Nothing in *Jones* ties the hands of the government in solving this problem, if it exists. And, in fact, the expert agencies are the ones likely better positioned to make both the judgment about whether there is a problem and, if there is, its most efficient solution.

### III. CIVIL PROCEDURE

Given the high costs and phantom benefits of § 36(b) litigation, efficiency is a compelling justification for Easterbrook's opinion in *Jones*. Bringing federal pay litigation in line with Delaware pay litigation would likely have resulted in lower litigation costs while preserving the ability to punish the worst abuses. A potential problem with all this for the rule-bound Judge Easterbrook is that, on their face, the Federal Rules of Civil Procedure do not obviously permit federal courts to weed out cases in the way that the Delaware Court of Chancery can. Delaware courts employ the demand requirement to give their expert judges a peek at the merits before discovery,<sup>99</sup> and the Court of Chancery is known for dismissing cases quickly and at early stages of the litigation, as soon as it believes the merits can be evaluated. In federal courts, at least before *Ashcroft v Iqbal*,<sup>100</sup> the notice-pleading standard of the current Rules allowed plaintiffs to proceed to discovery so long as they clearly stated a claim upon which relief could be granted.<sup>101</sup> In § 36(b) cases, this would seem to only require plaintiffs to complain that adviser pay was so high that it breached the statutory duty. Rule 8 does not seem to permit courts to dispense with § 36(b) cases at the motion to dismiss stage so long as the complaint is well pleaded. For the rule-loving Easterbrook, any attempt to short-circuit the merits at an earlier, arguably more efficient, time in the litigation looks a bit like what he rejected in *Vincent*.

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<sup>99</sup> See Del Ch Ct R 23.1 ("The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort."); *Stone v Ritter*, 911 A2d 362, 366–67 (Del 2006).

<sup>100</sup> 129 S Ct 1937 (2009).

<sup>101</sup> See FRCP 8(a)(2).

As discussed above, the discretion in the interpretation of “fiduciary” is one way around this problem.<sup>102</sup> But there is a better way. Although Easterbrook does not cite them, two recent Supreme Court cases, *Twombly* and *Iqbal*, implicitly amend the Federal Rules of Civil Procedure to bless the kind of end run that Easterbrook makes. These cases instruct lower courts to dispose of cases quickly and with low cost where discovery will not add value to the analysis a court will make. The idea is to reduce strike-suit incentives in cases in which the payoff from additional litigation expenses is less than or equal to zero. Richard Epstein describes what the Supreme Court was doing in *Twombly* as follows:

The truth of the matter, quite simply, is that the Supreme Court looked over the allegations in the complaint, thought of all the reasons why they did not make any sense in the context of this [ ] industry, and then refused to allow discovery to go forward because it had no confidence that thousands of hours of work would dredge up any new information that would alter its priors.<sup>103</sup>

A bare allegation of a price-fixing conspiracy, as was pleaded in *Twombly*,<sup>104</sup> would normally be sufficient to get past a motion to dismiss based on allegations of parallel conduct. According to Epstein, however, the Court concluded that the large discovery costs would not add much to the analysis beyond what was already available from public records, which are not costly to procure.<sup>105</sup> The general rule from *Twombly*, and thus the new rule of civil procedure,<sup>106</sup> is that where there are two plausible theories of the case (one benign and one sinister), and the answer about which one is more likely can be determined without taking the case further and imposing costs on the parties, courts should opt for an earlier decision on the merits. Epstein summarizes this reading of *Twombly*: “[D]iscovery is appropriate only

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<sup>102</sup> See text accompanying note 18.

<sup>103</sup> See Epstein, 25 Wash U J L & Pol at 77 (cited in note 23).

<sup>104</sup> 550 US at 564–66.

<sup>105</sup> See Epstein, 25 Wash U J L & Pol at 76–77, 82 (cited in note 23). See also *Twombly*, 550 US at 558, 566–69 (noting the expense of discovery and explaining why the existence of a conspiracy could not be reliably inferred from the facts presented by the plaintiffs).

<sup>106</sup> The Supreme Court writes the Federal Rules of Civil Procedure, and it can amend them formally, see 28 USC § 2072 (“The Supreme Court shall have the power to prescribe general rules of practice and procedure . . . for cases in the United States district courts . . . and courts of appeals.”), or informally through its opinions, see Charles Gardner Geyh, *Paradise Lost, Paradigm Found: Redefining the Judiciary’s Imperiled Role in Congress*, 71 NYU L Rev 1165, 1218 n 270 (1996) (noting that courts can often accomplish more through case law than formal rule-making). Consider also note 21.

when there is some evidence from some nonpublic source that justifies the greater expense of the discovery on the case.”<sup>107</sup>

Caution about the scope of the judicial role is warranted because there is an asymmetry between the two types of errors that courts can make. False positives (Type I errors) attribute sinister behavior where there is none, while false negatives (Type II errors) do not catch such behavior where it does exist. While both types of errors may arise, they should not have equal weight in assessing the costs of litigation when there exist external factors that discipline firms. If a cartel (as alleged in *Twombly*) or overpaying advisers (as alleged in *Jones*) is difficult to maintain in the long run because of market pressures, then false negatives will be rare because of this instability. False positives may be more likely, however, because of the ex post bias of litigation and the limited information and lack of expertise that courts have on these issues. In addition, it is difficult to undo a judicial order committing a Type I error, while a Type II error is unlikely to persist for long. *Twombly* hammers home this important gatekeeping function of pleading rules by trying to limit the judicial role where Type I errors likely swamp Type II errors.

Easterbrook’s opinion in *Jones* follows directly. There are perfectly sensible reasons why funds might charge lower fees for bigger customers (*Jones*’s best argument), and none of the facts about how much Harris was charging to whom was hidden from the public at the early stages of the litigation. In other words, the *Gartenberg* factors—for example, questions about economies of scale—apply across the board for all funds and are answerable at a general level. No one before *Jones* disputed that funds charged these different fees, that fees are fully disclosed, that there are different services provided to different customers, and so on. It may be that, as a normative matter, funds should charge unsophisticated investors less or sophisticated ones more, but this is beside the point.<sup>108</sup> Costly litigation is unlikely to aid our understanding or analysis of the problem.

Like the Court’s opinions in *Twombly* and *Iqbal*, *Jones* is about reducing the social costs of meaningless litigation. Easterbrook believes § 36(b) cases are unjustified, absent self-dealing or a problem with the pay-setting process, based on an analysis of the economics of mutual fund compensation. While this argument has some appeal, it is not even necessary. All the evidence one needs to conclude that the

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<sup>107</sup> Epstein, 25 Wash U J L & Pol at 81–82 (cited in note 23) (explaining that, because the plaintiffs relied exclusively on public information in *Twombly*, the Supreme Court appropriately treated the motion to dismiss as a “mini-summary judgment”).

<sup>108</sup> For an argument that unsophisticated investors benefit from higher fees, see Johnsen, *Myths about Mutual Fund Fees* at \*52–64 (cited in note 46).

game is not worth the candle with these cases is the simple fact that § 36(b) plaintiffs have never won, and yet they have filed hundreds of cases in an attempt to extract settlements from defendants.

#### CONCLUSION

Easterbrook's opinion in *Jones* is a remarkable opinion more because of what it does than what it says. The decision lays bare the costly but mutually beneficial game being played by both sides in mutual fund fee litigation. *Gartenberg* imposes a random but very small tax on mutual fund adviser compensation, which the industry can simply pass on to its investors. For nearly three decades, courts have handled hundreds of cases under this standard, and thereby allowed a multibillion dollar wealth transfer from investors to lawyers. Lawyers on both sides have a vested interest in maintaining the status quo, but so does the mutual fund industry.

Easterbrook's opinion was not one either party in *Jones* predicted or wanted.<sup>109</sup> The losers (the plaintiffs, their lawyers, and plaintiffs' lawyers generally) were given a much worse defeat than if Judge Easterbrook had just affirmed the district court's decision that the fees charged were not disproportionately large under *Gartenberg*. Easterbrook's opinion in *Jones* would have made future mutual fund compensation cases much less likely by making a breach of the statutory fiduciary duty much more difficult to prove. Plaintiffs would have had to show a lack of disclosure or conflict of interest on the board amounting to self-dealing;<sup>110</sup> simply asserting excessive pay would not have been sufficient as a matter of law. This means the business of bringing and defending these suits would have been much less profitable. The agency costs between investors and their lawyers and between funds and their lawyers may explain some of this status quo bias.

But even the winners were losers. The opinion generated a grant of certiorari, which imposed additional litigation costs on Harris. Judge Easterbrook tried to do away with this class of claims generally, and Harris was forced to pay the freight. But it is unlikely that the intended beneficiaries—mutual funds in general—were happy with the outcome in *Jones* either. The opinion raised the saliency of mutual fund pay at a politically inopportune time, and might have generated a

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<sup>109</sup> Amazingly, no briefs at the Supreme Court defend the approach Judge Easterbrook took. The amicus brief of the industry, submitted by the Investment Company Institute, asserts that *Gartenberg* provides "real and substantial protection to investors." Brief for the Investment Company Institute as Amicus Curiae Supporting Respondent, *Jones v Harris Associates*, No 08-586, \*9 (US filed Sept 3, 2009) (available on Westlaw at 2009 WL 2896317) ("ICI Brief") (praising *Gartenberg*'s ability to weed out meritless claims before trial).

<sup>110</sup> *Jones*, 527 F3d at 632.

rule the industry likes less than the prevailing *Gartenberg* rule, or, even worse, legislative action. (Better *Gartenberg* than Barney Frank.) We can think of the *Gartenberg* rule as a “tax” on mutual fund profits, and it may be rational for mutual fund advisers to prefer this very small tax to the risk of a reconsideration of adviser pay generally, especially when they can simply pass on the tax to investors. Insofar as the tax is small and random,<sup>111</sup> no individual fund or the industry as a whole should be bothered by the current rule. It should not be surprising, therefore, that the industry called for *Gartenberg* to be reinstated.<sup>112</sup>

Easterbrook’s opinion in *Jones* boldly tried to end this profitable game by calling the bluff of the lawyers and the funds. The importance of *Jones* lies in the fact that everyone involved—the advisers, the courts, the lawyers—was fine with the existing regime. But the investors § 36(b) was designed to help were not helped by it, and what Easterbrook tried to do in *Jones* was protect them from the costs that § 36(b) litigation passes on.

Easterbrook’s opinion, which essentially is about collapsing the merits inquiry into the motion to dismiss stage, also points to the danger of the federalization of corporate law issues generally. As noted above, state courts are much better at processing fiduciary duty claims efficiently.<sup>113</sup> Delaware courts have a long tradition of collapsing litigation in this way, through mechanisms like the demand-excuse doctrine and expert courts that are able to efficiently sort meritorious from meritless cases and are willing to dismiss meritless cases quickly. Section 36(b) and state fiduciary duty law on executive compensation are nearly indistinguishable, and yet state courts are not subjected to the same strike suits that federal courts have been. This may be because federal courts apply the pleading and discovery rules similarly across substantive areas out of a fear that balkanizing the rules risks dismissing cases that would vindicate important rights. Whereas the specialized Delaware business courts can apply merits-collapsing rules in corporate law cases without risk of deterring tort or civil rights suits, the same might not be true of federal courts. If true, then we should resist attempts to bring more corporate law matters under the jurisdiction of federal courts.

This concern may be ameliorated to some extent by the Supreme Court’s recent civil procedure jurisprudence. We can view *Twombly* and *Iqbal* as attempts by the Supreme Court to delineate some stan-

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<sup>111</sup> There is some evidence that the suits are not random, but are correlated with asset inflows. See notes 89–92 and accompanying text.

<sup>112</sup> ICI Brief at \*6–9 (cited in 109) (arguing that the *Gartenberg* framework has produced “a remarkably stable and cohesive body of law that has provided welcome guidance”).

<sup>113</sup> See notes 65–69, 99–101, and accompanying text.

dards for targeting the Federal Rules of Civil Procedure, in particular substantive areas, based on the external forces and incentives of the litigants and third parties. Antitrust and national security issues are already identified as areas in which federal courts should be attuned to the tradeoffs between the costs of litigation and the information needed to make good decisions.<sup>114</sup> Judge Easterbrook's opinion in *Jones* suggested that mutual fund adviser compensation is one of these areas too. It is too bad the Supreme Court didn't listen.

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<sup>114</sup> See *Twombly*, 550 US at 558–59; *Iqbal*, 129 S Ct at 1953.