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Federal Court Issues Trial Ruling in Section 36(b) “Manager of Managers” Lawsuit: AXA Advisory and Administrative Fees Held Not to Constitute a Breach of Fiduciary Duty

The U.S. District Court for the District of New Jersey issued its post-trial ruling on August 25, 2016 in *Sivolella v. AXA Equitable Life Insurance Company*—the first Section 36(b) trial decision since 2009. The Court concluded that Plaintiffs had failed to meet their burden to show that two AXA entities breached their fiduciary duty under Section 36(b) by charging excessive advisory and administrative fees to 12 AXA-sponsored mutual funds. The lengthy opinion highlights the heavy burden plaintiffs face in Section 36(b) cases. It also serves as a reminder of the importance of witness expertise and credibility. Finally, as the first Section 36(b) case to go to trial following the Supreme Court’s decision in *Jones v. Harris Associates, L.P.*,¹ and the first trial of the “manager of managers” theory of liability, the AXA case has the potential to influence a number of the pending mutual fund “excessive fee” cases around the country.

Section 36(b) of the Investment Company Act of 1940 (1940 Act) imposes a fiduciary duty on an investment adviser to a mutual fund “with respect to the receipt of compensation,” and gives mutual fund shareholders a private right of action to enforce that duty. The statute expressly assigns to any such plaintiff the burden of proof, and subsequent case law makes clear that a breach may be shown only where the fee charged 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.”²

In *Jones*, the Supreme Court cited with approval the use of several commonly-considered factors set forth in an earlier case decided by the Second Circuit, *Gartenberg v. Merrill Lynch Asset Management, Inc.*,³ but emphasized the ultimate “arm’s length bargain” standard. These so-called “*Gartenberg* factors” are: (i) the nature, extent, and quality of the services provided by the adviser to the mutual fund(s) it advises; (ii) the profitability to the adviser of managing the fund; (iii) “fall-out” benefits; (iv) the existence of any economies of scale achieved by the adviser as a result of growth in fund assets under management (AUM), and whether any such savings are shared with fund shareholders; (v) fee structures utilized by other similar funds;⁴ and (vi) the expertise of the fund’s independent directors, whether the independent directors are fully informed about all of the facts bearing on the adviser’s service and fee, and the extent of care and conscientiousness with which the independent directors perform their duties with respect to the adviser’s fee. In applying these

factors, however, *Jones* explains that the informed decisions reached by a fund's independent directors deserve special consideration: "a measure of deference to a board's judgment may be appropriate in some circumstances" and "the appropriate measure of deference varies depending on the circumstances."⁵ Further, where the independent directors "considered the relevant factors, their decision to approve a particular fee agreement is entitled to considerable weight, even if a court might weigh the factors differently."⁶

The AXA case was brought against AXA Equitable Life Insurance Company (AXA) and AXA Equitable Funds Management Group (FMG), and challenged the fees paid by 12 series (Funds)⁷ of EQ Advisers Trust (EQAT). Plaintiffs owned variable annuity contracts issued by AXA through which they had allocated a portion of their investment to the Funds. FMG provides advisory and administrative services to mutual funds offered through AXA's variable annuity contracts, including the Funds, pursuant to an investment advisory agreement and administrative agreement, respectively.

Prior to the AXA litigation, the Section 36(b) cases that had reached trial had challenged the role of a single investment adviser or administrator (*i.e.*, none had challenged the use of sub-advisers or sub-administrators to provide services to the funds advised). The AXA complex, however, utilizes a "manager of managers" model, as do many others in the industry. Under this model, FMG as adviser to the funds engages sub-advisers or sub-administrators to provide certain advisory and administrative services, while FMG retains ultimate responsibility for such services, performs additional services, and bears attendant regulatory and entrepreneurial risks, among other things. Plaintiffs' challenge to the Funds' advisory and administrative fees was premised on the notion that FMG had delegated all of its responsibilities to the sub-advisers and the sub-administrator, and therefore the portion of the fee retained by FMG was inherently unreasonable.

Following a 25-day bench trial, which produced extensive fact and expert testimony and detailed post-trial proposed factual findings and legal conclusions, the Court concluded that Plaintiffs had failed to meet their burden of demonstrating that FMG's fees were excessive. In its opinion, the Court made several credibility determinations and conducted an analysis of each *Gartenberg* factor, ultimately finding that Plaintiffs' documentary and testimonial evidence failed to establish a breach of fiduciary duty under Section 36(b).

The Court's opinion reinforces the significant burden that a Section 36(b) plaintiff faces to prove that a fee received by an investment adviser is excessive. Indeed, the Court repeatedly concluded that Plaintiffs had failed to meet their burden either on individual *Gartenberg* factors or the ultimate question of liability. As a result, the Court did not hold that Defendants had affirmatively demonstrated that the advisory and administrative fees could have been the product of arm's length bargaining, nor did the Court rule as a matter of law that a "manager of managers" lawsuit could never prove successful. Instead, the Court conducted a methodical evaluation of the evidence and testimony relating to each *Gartenberg* factor before finding that Plaintiffs had failed to meet their burden of proof.

Expertise, Independence, Care, and Conscientiousness of Funds' Board of Trustees

The Court credited the conscientiousness exercised by the Funds' Board of Trustees in reviewing and approving the relevant advisory and administrative agreements with FMG pursuant to Section 15(c) of the 1940 Act (the 15(c) process).⁸ In so doing, it rejected Plaintiffs' primary claims related to: (i) a potential conflict caused by the CEO of FMG serving as Chairman of the Board; (ii) a lack of Trustee diversity; and (iii) the fact that FMG was primarily responsible for compiling and providing the materials considered by the Funds' Board. As discussed below, on each of these issues, the Court credited the testimony of the Board's lead Independent Trustee rather than that of Plaintiffs' experts:

- The Court found persuasive the lead Independent Trustee's testimony that while FMG's CEO served as Board chair, that relationship was not "cozy" and was "arm's length," as evidenced by the Independent Trustees' ultimate control over Board meeting calendars and discussions, as well as their authority to require changes to FMG's management of the Funds as needed.
- The Court credited testimony related to the role and intent of the lead Independent Trustee to be "as good an independent trustee as I thought I could be."
- With respect to the alleged lack of diversity of the Board, the Court recognized testimony regarding the non-financial services industry background of two Independent Trustees, as well as the lead Independent Trustee's testimony that the trustees each "bring different areas of expertise," and "an interest in looking out for the investors."

- The Court also credited the lead Independent Trustee’s testimony related to FMG’s provision of information to the Funds’ Board, which established that in addition to FMG-provided information, the Board also received pertinent information from outside experts (including legal counsel and industry groups).

The Court also conducted a holistic review of the Board’s practices and procedures, which included noting the frequency of Board meetings and the work of Board committees. The Court also reviewed the Board’s trustee compensation and training processes, noting that compensation was set in conjunction with outside counsel, and observed that new trustees received a “comprehensive” training program. The Court also acknowledged the role of outside counsel for the Funds as well as the independent counsel hired by the Independent Trustees. Finally, the Court reviewed the testimony of Plaintiffs’ board governance expert, finding that the expert “lacked credibility on a number of pertinent issues,” partly because that expert “did not review pertinent information” or “consider in-depth deposition testimony of [B]oard members.” Taken collectively, the Court found that the Board was “careful and conscientious in executing its duties.”

Separately, however, the Court stated (in dicta) that the Board apparently made certain enhancements to its governance structure and processes, including its 15(c) process, as a consequence of the filing of the lawsuit against AXA. These included selecting a lead Independent Trustee following the filing of the Complaint. The Court also opined that Board expenses were more carefully examined following the lawsuit, and identified other changes made to the compilation of Board materials, including charts designed to assist the Board in analyzing the fees retained by FMG after the sub-advisers were paid. The Court concluded, “[a]lthough the substance of this lawsuit showed little proof, the filing of the suit brought about positive change to the Board’s composition and process.”

Nature, Extent, and Quality of Services

The Court next reviewed the nature and quality of the services provided by FMG and AXA. As an initial matter, the Court considered Plaintiffs’ claim that the services enumerated in the Funds’ investment management agreement and administrative agreement controlled the analysis of what services were provided to the Funds. Although the Court acknowledged that, based solely on the language of the agreements, the sub-advisers (and in certain cases, the sub-administrator) performed the same services for which FMG was responsible, the Court rejected Plaintiffs’ assertion that the Court was constrained to consider only the services expressly enumerated in the agreements. Instead, the Court found that it was more appropriate to review the substantive evidence regarding the advisory and administrative services actually provided. The Court concluded that the services actually provided were broader than those enunciated in the advisory and administrative agreements, and that those actual services controlled its *Gartenberg* analysis.

In contrast, the Court was unable to complete any analysis regarding the fees FMG retained. Remarkably, the Court found that the parties failed to provide evidence at trial regarding the amount of fees that FMG retained during most years in dispute. As a result, the Court found that the only reliable information about fees were the stipulated figures regarding the fees paid to sub-advisers and the sub-administrator. This, however, left the Court without information regarding how much FMG retained in fees—making the “ultimate decision in this case nearly impossible.”

The Court then turned to the actual services FMG performed, discussing FMG’s efforts on the Funds’ behalf, including:

- FMG’s selection and monitoring of sub-advisers, including ongoing compliance oversight, due diligence, and performance monitoring.
- FMG’s provision of a broad range of portfolio management services, including formulating each Fund’s initial investment strategies, proposing structural changes to the Funds as necessary, allocating and re-allocating Fund assets to individual sub-advisers, and certain portfolio holding valuation services.
- FMG’s retention of risks associated with the Funds, specifically enterprise risks to reputation, the potential for litigation, and operational and business risks. The Court credited FMG’s assumption of various risks despite Plaintiffs’ claim that such risks had not been quantified. This turned on a finding that Defendants’ expert on the topic, who stated that industry practice during the relevant time was to engage in a qualitative, rather than quantitative, risk assessment, was credible.
- FMG’s compliance and legal function, including coordinating with counsel for the Funds and the

Independent Trustees (such as preparation of Board materials and maintaining books and records), and participating in SEC examinations and inquiries as well as internal and external audits.

Taken collectively, the Court concluded that Plaintiffs failed to show that FMG delegated “all of its duties.” The Court held that to adopt Plaintiffs’ position that the Court should consider only the services specifically referenced in the contracts would be to elevate “form over substance” and would require the Court to ignore extensive first-hand testimony of FMG employees.

In a similar vein, the Court reviewed the services AXA provided to support FMG as manager to the Funds. These included legal services like the Funds’ anti-money laundering program and certain regulatory filings (e.g., filings with state insurance departments), as well as the provision of a disaster recovery program and three call centers employing “roughly one thousand people” to provide support to new and existing investors. Finally, the Court also noted that AXA provides broad infrastructure and support services to FMG, including human resources and accounts payable functions. The Court thus concluded that AXA “performed a number of services” to support the Funds and FMG.

Profitability to the Adviser

Another disputed issue in the case concerned the method by which FMG calculated its profitability in managing the funds. In its profitability calculations presented to the Board, FMG treated the fees paid to the Funds’ sub-advisers and the sub-administrator as direct expenses incurred by the adviser. FMG also included as expenses certain “allocated costs” charged by AXA to FMG for services AXA performed in support of the Funds. Plaintiffs contended that because the sub-advisory and sub-administrative fees were paid by wire transfer directly from EQAT rather than from FMG’s account, FMG should not have claimed the sub-advisory and sub-administrative fees as expenses. Plaintiffs also argued that AXA’s and FMG’s allocation methodologies were improper because they included revenue as a cost driver. Plaintiffs asserted that if AXA should allocate any costs to FMG, such costs should be limited to those associated with a Shared Services Agreement between AXA and FMG.⁹ According to Plaintiffs, if profitability were calculated in an appropriate manner, FMG’s profitability would be 90% or more, and therefore also much higher than peer firms.

The Court rejected Plaintiffs’ expert’s opinion that it was improper to treat the fees paid to sub-advisers and the sub-administrator as expenses to the adviser for purposes of calculating the adviser’s profitability in managing the Funds. Instead, the Court credited the opinion of Defendants’ expert that such treatment is consistent with ordinary accounting principles. The Court specifically found that Plaintiffs’ accounting expert was “not credible” because his testimony on this point was inconsistent. The Court also referenced testimony from the Funds’ lead Independent Trustee that the Independent Trustees had consulted with their independent counsel to ensure that the method in which FMG calculated profitability was consistent with industry practice, and noted that two independent accounting firms which reviewed FMG’s profitability calculations had determined that FMG’s approach was appropriate. Finally, in addressing Plaintiffs’ criticism of the use of revenue to allocate expenses, the Court observed that Plaintiffs’ expert did not identify an alternative cost allocation methodology, indicating that Plaintiffs’ expert had stated that he could not create such a methodology without being provided with FMG’s expenses.

With respect to the costs that AXA had allocated to FMG, the Court explained that the Shared Services Agreement obligated FMG to pay for certain costs incurred by AXA in providing services that benefited the Funds. On a yearly basis, AXA calculated the amount of direct and indirect expenses attributable to those services, and FMG was obligated to pay that amount to AXA. While Plaintiffs argued that the indirect costs attributed to FMG were unduly large and improper, the Court rejected that contention, observing that Plaintiffs’ experts showed little familiarity with the services that were provided pursuant to the Shared Services Agreement, and had not reviewed the Shared Services Agreement in any level of detail. The Court also referenced testimony from FMG’s CEO that the Shared Services Agreement covered only services and expenses associated with approximately 50 “dual-hatted” AXA employees providing services to FMG, but did not cover other services provided by other AXA employees in support of FMG’s services to the Funds.¹⁰ The Court determined that Plaintiffs had “raised a valid point that the US\$49 million in allocated expenses is not adequately accounted for,” yet had failed to identify any credible evidence that the allocated expenses were duplicative of other expenses charged. As a result, although the Court expressed some concern as to the documentation of the costs AXA had assigned to FMG, the Court concluded that Plaintiffs had failed to carry their burden of showing that FMG’s methods of allocating expenses and calculating profitability were

improper.

Economies of Scale

The Court next considered whether FMG had appropriately shared economies of scale with the Funds. The parties did not dispute that the AUM of the Funds had increased significantly from 2010 to 2014. Nevertheless, the Court noted that whether AUM had increased is a separate question from whether economies of scale existed and whether any such economies were shared with fund shareholders. The Court observed that the most common way of sharing economies of scale is through the use of breakpoints in the fee schedules, which reduce the effective advisory fee rate as AUM increase. Although it was undisputed that each Fund had breakpoints in its advisory fee schedule, and each Fund currently had breakpoints in its administrative fee schedule,¹¹ the Court stated that the fee schedules for the sub-advisers to the Funds often had asymmetrical breakpoints (*i.e.*, certain sub-advisory fee breakpoints were set at lower levels of AUM than were the advisory fee breakpoints). As a result, at certain levels of AUM the sub-advisory fee would decrease while the advisory fee would not, resulting in FMG retaining a greater percentage of the fee paid by the Funds. The Court nevertheless concluded that none of Plaintiffs' experts had adequately quantified either the value of economies of scale enjoyed by FMG, or the amount that should have been shared with investors in the Funds.

One of the three experts Plaintiffs offered on the subject of the mutual fund industry and investments and economies of scale calculated the amount that the Funds had saved as a result of the breakpoints reached by the Funds. However, the expert opined that the amount saved by the Fund was "marginal" because half of the amount saved by the Funds resulted from breakpoints in the sub-advisory fee schedules, which benefited FMG rather than the Funds. Plaintiffs' economies of scale experts also concluded that FMG's costs remained relatively constant over time, despite the growth of the Funds and the consequent increase in advisory fees paid to the adviser.

Defendants' expert on economies of scale, in contrast, testified that FMG's costs had increased over time. Defendants' expert criticized Plaintiffs' experts because the latter had only accounted for direct costs to FMG, but had not allocated costs or variable costs such as the fees paid to the sub-advisers. Defendants' expert also observed that Plaintiffs' experts had failed to calculate per-unit cost to the adviser of managing the Funds, which Defendants argued was a critical failing.

In ruling on economies of scale, the Court found the copious amount of information provided to the Funds' Board on economies of scale to be persuasive, repeatedly citing presentations and information provided to the Board throughout its discussion of economies of scale. The Court referenced testimony from the Funds' lead Independent Trustee that the Independent Trustees strove to ensure that economies of scale were shared with the Funds through breakpoints and fee reductions. The Court found that the opinion offered by Plaintiffs' economies of scale experts, which concluded that FMG's costs had been "fairly consistent over time," was "inconsistent with economies of scale" and therefore unpersuasive. The Court also found that Plaintiffs had overlooked other methods by which FMG shared economies of scale with the Funds, including product cap reimbursements,¹² expense limitation agreements, pricing to scale,¹³ and directed brokerage. As a result, the Court found that Plaintiffs had failed to establish the existence of economies of scale that were not shared with the Funds.

Fall-Out Benefits

The Court opened its analysis of fall-out benefits by recognizing a dispute between the parties regarding the standard that should apply to the determination of fall-out benefits. Defendants advocated for a "but-for" standard, where a benefit should only be deemed a fall-out benefit if it would not have been realized by the adviser "but for" its relationship with the fund. Plaintiffs, in contrast, argued that fall-out benefits consist of any benefit the adviser enjoys "as a result of" its relationship with the fund. The Court preliminarily noted that it had precluded one of Plaintiffs' experts from offering an opinion on fall-out benefits because he had admitted that he did not have expertise in fall-out benefits, and the Court observed that Plaintiffs' other proffered expert on fall-out benefits had also admitted during his trial testimony that he was not an expert on the subject. Nevertheless, the Court proceeded to consider the parties' substantive arguments on fall-out benefits. The Court ultimately found that Plaintiffs had failed to present any evidence capable of establishing what a fall-out benefit was, and thus had failed their burden of proof.

Plaintiffs argued that the fall-out benefits accruing to FMG included “product wrapper fees,” “general account spread,”¹⁵ and fees paid to Alliance Bernstein and its brokerage unit Bernstein, both affiliates of AXA. FMG’s CEO testified that the fall-out benefits identified to the Board for consideration included dividend received deductions, foreign tax credits, fees paid to Alliance Bernstein, distribution, and product wrapper fees. The parties disputed, however, whether product wrapper fees had been identified to the Board as a potential fall-out benefit.

Plaintiffs contended that product wrapper fees had been identified in presentations from 2000 to 2005, while FMG’s CEO testified that such fees had been listed as potential fall-out benefits for almost the entire period at issue. FMG’s CEO further testified that he would consider product wrapper fees to be fall-out benefits only in circumstances in which the ability to invest in the Funds was the motivating reason for an investor to purchase a variable annuity contract, and that those circumstances would be rare if they occurred at all. As FMG’s CEO testified, “I can eliminate all the [F]unds, [and] these [product wrapper fee] revenues would still exist.” He stated that FMG and the Board had reached a consensus that product wrapper fees were not fall-out benefits.

With respect to general account spread, the Court credited the testimony of FMG’s CEO that he believed that the general account spread could not be considered even a theoretical fall-out benefit because it was a mutually exclusive investment alternative to a mutual fund. In contrast, the Court found that Plaintiffs’ expert’s opinion to the contrary was unpersuasive because it relied on one page of a presentation and that expert had also admitted that the general account was unrelated to the Funds.

The Court noted that Defendants did not dispute that fees paid to AXA’s affiliate Alliance Bernstein could be considered a fall-out benefit, and that those fees were reported to the Board as such. The Court held that “the credible testimony demonstrates that the Board was apprised that the fees paid to Alliance Bernstein constitute fall-out benefits,” and that Plaintiffs had failed to demonstrate that FMG received improper fall-out benefits “because the evidence shows that the Board considered these fees in approving the investment management and administrative contracts.” Given the Court’s finding that Plaintiffs had failed to meet their burden, the Court did not resolve what legal standard should apply to determine fall-out benefits.

Comparative Fee Structures

The Court next turned to comparative fees, noting its obligation to give such comparisons the weight they merit in light of the similarities and differences in the services provided. While the parties did not dispute that the Board had been provided with information regarding comparative fees, Plaintiffs contended that the information that the Board received was unreliable. Plaintiffs alleged that: the information compiled by Lipper (a leading third-party source of fee information) did not correctly analyze the fees paid by the Funds, because Lipper compared the Funds to dissimilar funds; and that a proper analysis would show that the fees paid by the Funds were significantly higher than peer funds.

The Court noted that Plaintiffs’ experts on comparative fees both admitted that Lipper was a respected industry source, and observed that one of Plaintiffs’ experts had admitted he uses Lipper data to create his own fee comparisons. The Court also recognized Defendants’ expert’s testimony that Lipper was a credible third-party source of fee information and that the expert had determined the expenses for the Funds to be approximately around the group medians for the industry. Ultimately the Court concluded that given Plaintiffs’ experts’ conflicting testimony as well as the testimony offered by Defendants’ expert, the information provided to the Board regarding comparative fees was reliable, and Plaintiffs had failed to meet their burden to show that the fees paid by the Funds were excessive compared to other funds.

Fund Performance

The Court stated that performance was not itself a separate *Gartenberg* factor, but considered Plaintiffs’ contention that the Funds performed poorly and that this poor performance indicated that the nature and quality of services provided to the Funds was inferior. The Court briefly referenced Plaintiffs’ experts’ general opinion that the Funds had underperformed, before summarizing in depth the testimony provided by Defendants’ expert on performance.

Defendants’ expert noted that the actively-managed Funds had performed in line with or outperformed their benchmarks, and that the passive Funds had tracked their benchmarks as intended and thus performed well. With respect to the “pactive” Funds, which combined both actively-managed and passive sleeves,

Defendants' expert opined that any underperformance was due to the passive sleeves of the Funds rather than the active sleeves. Defendants' expert also pointed out that the analysis performed by Plaintiffs' experts had annualized performance over a given five-year period, which did not comport with the industry standard for analyzing performance. Finally, Defendants' expert identified various mathematical and methodological errors in the analysis performed by the experts for Plaintiffs.

In light of the failings in Plaintiffs' experts' opinions identified by Defendants' expert, the Court concluded that it would give considerable weight to the opinion offered by Defendants' expert, and little weight to the opinion offered by Plaintiffs' experts. The Court found that Plaintiffs' experts' analysis was "less credible and inferior" to that performed by the defense expert, and that Plaintiffs had failed to establish that the Funds had received inferior services as evidenced by underperformance.

Damages

Despite the fact that Plaintiffs had not proven the elements of their claims, the Court considered whether Plaintiffs had established the existence of damages. The Court held that Plaintiffs had failed to establish damages. The Court noted that Plaintiffs had primarily attempted to prove damages through the use of charts submitted in post-trial briefing, but observed that those charts had not been admitted into evidence and had little link to the evidence offered at trial. As a result, the Court refused to consider them. The Court held that "[a] party cannot cure flaws or inaccuracies in its trial presentation through post-trial submissions by simply submitting new charts and updated calculations," because such a procedure would deprive the opposing party of the right to cross-examination.

On the merits, the Court rejected Plaintiffs' first damages model, which called for disgorgement of FMG's entire fee, because there was no evidence that FMG had performed no services and thus was entitled to no fee. Plaintiffs' fourth damages model compared FMG's fee to low-cost providers such as Vanguard, which the Court found to be improper because "Plaintiffs presented no credible evidence demonstrating that FMG's services are appropriately comparable to those performed by Vanguard." The Court further concluded that while the remaining damages models submitted by Plaintiffs were theoretically viable, they were not disclosed or admitted into evidence at trial, and Plaintiffs' only expert to testify as to damages was not credible due to mathematical errors in his calculations as well as his failure to calculate damages for the entire damages period. The Court also rejected these models because they relied on a proposed reasonable profit margin for FMG, but Plaintiffs' evidence and expert testimony on profit margin was flawed in several respects. As a result, the Court found that Plaintiffs had failed to establish actual damages suffered by the Funds.

Takeaways from the AXA Court's Ruling

The Court's opinion in the AXA case reinforces the central role of funds' boards. As a result, it remains imperative that fund boards receive information concerning all significant aspects of the adviser's and affiliates' relationships with the funds, that the independent members of the board receive competent independent counsel, and that independent trustees or directors pay close attention to their role as "independent watchdogs" for the shareholders in the funds. The Court's ruling also highlights the extremely heavy burden a plaintiff bears to establish a mutual fund adviser's breach of fiduciary duty and the level of complexity involved in these types of cases—and the concomitant impact on the role of the court in such litigation.

Despite the lengthy period of time given for the parties in AXA to develop their case, the sheer amount of information involved posed legal, organizational, and logistical issues for both the parties and the Court. Yet this fact highlights why it is that fund boards, not courts, are entrusted with overseeing the relationship between the adviser and the fund in the first instance. As the Court itself recognized, both explicitly and implicitly at several points in its opinion,¹⁶ given the relative expertise of the mutual fund boards in fund management and affairs, fund boards have a greater institutional competency to oversee the relationship between funds and their advisers than do courts. Courts are not tasked with "judicial second-guessing of informed board decisions,"¹⁷ and the Court's opinion rightly signals the relatively limited role trial courts have in determining the propriety of a particular advisory fee.

The AXA decision also highlights the pivotal role of credibility determinations, particularly related to expert witness testimony which "had a significant impact on the outcome of the case." Twelve pages of the opinion

are devoted to the Court's "Credibility Determinations" regarding the parties' key fact and expert witnesses. Because the large factual record largely concerned FMG's services—testimony that "did little to determine" whether a breach of fiduciary duty had occurred—the Court was more reliant on the parties' expert witnesses. The Court largely discounted Plaintiffs' experts, describing specific expert witnesses as "evasive," "at times unprofessional and sarcastic," or to have "half-heartedly prepared his opinion." Witness credibility can play a central role in any litigation. The AXA decision is a reminder of that paradigm.

It remains to be seen what impact the AXA decision may have on currently pending or future Section 36(b) cases. But at a minimum, all participants in the 15(c) process should pay close attention to the AXA decision and the other Section 36(b) decisions that may soon follow.

Footnotes

- 1) 559 U.S. 335 (2009).
- 2) *Jones*, 559 U.S. at 346.
- 3) 694 F.2d 923 (2d Cir. 1982).
- 4) Although comparative fees are often cited as a *Gartenberg* factor, the Supreme Court in *Jones* cautioned that "courts should not rely too heavily on comparisons with fees charged to mutual funds by other advisers," and instead directed that courts "may give such comparisons the weight that they merit in light of the similarities and differences between the services that the clients in question require." *Jones* 559 U.S. at 349-50.
- 5) *Jones*, 559 U.S. at 349.
- 6) *Id.* at 351.
- 7) The 12 Funds were: the EQ/Common Stock Index Portfolio; EQ/Core Bond Index Portfolio; EQ/Equity 500 Index Portfolio; EQ/Equity Growth PLUS Portfolio; EQ/GAMCO Small Company Value Portfolio; EQ/Global Bond PLUS Portfolio; EQ/Global Multi-Sector Equity Portfolio; EQ/Intermediate Government Bond Index Portfolio; EQ/Large Cap Value PLUS Portfolio; EQ/Mid Cap Value PLUS Portfolio; EQ/PIMCO Ultra Short Bond Portfolio; and EQ/T. Rowe Price Growth Stock Portfolio. Several of these Funds were renamed or underwent organizational changes. Because these changes did not impact the Court's decision, they are not set forth in detail here.
- 8) Section 15(c) requires a mutual fund's board to review and, if appropriate, approve the agreement(s) between the mutual fund and its investment adviser on a yearly basis.
- 9) The Shared Services Agreement was an intracompany agreement entered into between AXA and FMG in order to define the expenses of FMG as a subsidiary to an insurance company, as required by certain state insurance laws.
- 10) These other services included, among others, legal services, bankruptcy services, anti-money laundering consulting, and the provision of phone and service centers.
- 11) During the period May 2009 through July 2010, five Funds did not have breakpoints in their administrative fee schedules.
- 12) Product cap reimbursements place a cap on the fees paid by a particular product, and obligate FMG to reimburse shareholders for any amount over that cap.
- 13) FMG's CEO testified that FMG would also periodically re-price funds that were losing AUM, in order to keep them competitive in the marketplace.
- 14) In this context, product wrapper fees are fees paid by investors when they enter into an annuity contract.
- 15) Here, the general account is an investment option that guarantees a fixed amount of return every year. The general account spread is the difference between the amount earned on investments in the general account and the guaranteed amount paid to investors. If the general account earned a greater return than the return guaranteed to investors, that difference would be retained by FMG.
- 16) See, e.g., 2016 WL 4487857, at *35 (D.N.J. Aug. 25, 2016) (recognizing that "the Board would likely possess the foundational understanding that the Court lacks in deciphering" charts summarizing the amounts paid to FMG versus the sub-advisers).
- 17) *Jones*, 559 U.S. at 352.

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