The Law and aEconomics of Mutual Fund
Investment-Adviser Fiduciaries: Jones v.
Harris Associates L.P.

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THE LAW AND ECONOMICS OF MUTUAL FUND INVESTMENT-ADVISER FIDUCIARIES:
JONES v. HARRIS ASSOCIATES L.P.

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The following pages assess the widely-anticipated March 30, 2010, opinion of the Supreme Court of the United States in Jones v. Harris Associates L.P. That opinion by Justice Samuel Alito widened the door for future litigation brought by, e.g., mutual fund shareholders challenging the fees accorded to the investment advisers of their funds. Such investment advisers of mutual funds typically create the funds they thereupon advise and dominate—hence, captive mutual funds. The Investment Company Act of 1940, as amended in 1970, attached upon an investment adviser of a registered investment company a fiduciary duty respecting that adviser’s compensation for services paid by such company. The Jones controversy reached the Supreme Court only after its turbulent vetting in the United States Court of Appeals for the Seventh Circuit by such notables of the scholarly field of law.


2. 130 S. Ct. 1418 (2010).


and economics as the Seventh Circuit’s Chief Judge Frank H. Easterbrook 
and Judge Richard A. Posner.

Gartenberg v. Merrill Lynch Asset Management, Inc., 5 a 1982 opinion 
out of the United States Court of Appeals for the Second Circuit, so con-
strued the fiduciary duty element of the 1970 amendments to the 1940 Act 
that litigation thereafter in excessive fee cases dispensed judgments virtually 
uniformly for defendants. Subsequently would experts in the economic 
analysis of law, Easterbrook and Daniel R. Fischel, pronounce that nothing 
special inheres in fiduciary relationships. Fiduciary duty, rather, is a func-
tion of transaction costs. In Jones, Chief Judge Easterbrook replied to an 
attack under the amendments to the Investment Company Act by sharehold-
ers in captive mutual funds against their funds’ investment adviser’s remune-
ration. Easterbrook broke with Gartenberg in an opinion pitched almost 
entirely to the element of the fiduciary-investment adviser’s disclosure to its 
captive mutual fund’s own board. Both the appellate-level opinions in Gar-
tenberg and in Jones brushed aside plaintiff bids to benchmark the invest-
ment advisory fees charged to their captive mutual funds against fees 
charged independent clients like pension funds. 6 In his dissent from the 
denial of rehearing en banc in Jones, Judge Posner contrariwise dwelt on the 
Jones investment adviser’s charging captive funds more than twice what it 
charged to independent funds. 7

Justice Alito’s opinion tracked less the Easterbrook reasoning in Jones 
than the Gartenberg path: To risk liability for breach of its fiduciary duty, an 
investment adviser must collect compensation so disproportionately great as 
to bear no reasonable relation to the rendered services and as cannot be an 
outcome of an arm’s-length bargain. 8 But Alito submits a Gartenberg-plus 
opinion in Jones. It expressly disavows any categorical rule forestalling 
comparisons between those fees an adviser charges a captive mutual fund 
and those it levies upon independent clients. Unsettlingly, perhaps, for mu-
tual fund investment advisers, economics scholarship immediately post-
Jones reported on the cost structure and performance of a large sampling of 
America’s pension funds. It disclosed that mutual fund fees substantially 
exceed pension fund costs, possibly due in part to pension funds’ greater

5. 694 F.2d 923 (2d Cir. 1982).
6. Id. at 925; Jones, 527 F.3d at 631.
7. Jones v. Harris Assocs. L.P., 537 F.3d 728, 731 (7th Cir. 2008) (Posner, J., dissent-
ing) (per curiam).
8. See Rob M.M.J. Bauer et al., Pension Fund Performance and Costs: Small Is Beauti-
papers.cfm?abstract_id=965388.
sizes, which could entail enhanced bargaining power.\textsuperscript{9} The performances of defined benefit contribution funds outdo those of defined contribution pension funds. This suggests that monitoring external managers and invoking bargaining muscle to drive down costs is more efficient in the former, potentially due to improved incentives.\textsuperscript{10} And Alito adds that fees can be excessive even when negotiated by a board possessing all relevant information.

Immediately apprehended in numerous quarters was the potential thrust of the Jones Gartenberg-plus opinion. That tendency could be pressure on the investment advisers of captive mutual fund boards to justify in detail, and perhaps to reduce, their investment advisory charges. This pressure would conduce to the financial benefit of retail—not institutional—investors. Unfortunately, the salutary payoffs hopable from Jones had not already been conjured for investors by the Securities and Exchange Commission.

This 2010 Jones opinion closely comports with the law and economics propounded neither by Easterbrook—with his linkage of fiduciary duty to transaction costs—not by Posner, who links fiduciary duty with the unequal information costs problem. It squares with the thought of Nobel laureate economist Sir James A. Mirrlees, and of fiduciary law specialist Tamar Frankel of Boston University. Mirrlees perceives the distinguishing feature of principal-agent relationships to be asymmetry in responsibilities, with the principal as first mover and agent as the second. Frankel teaches that first mover-mutual fund investors (principals) can be hostages of vulpine second mover-investment advisers (agents).

II. \textit{GARTENBERG v. MERRILL LYNCH ASSET MANAGEMENT, INC.}

In the United States Court of Appeals for the Second Circuit case of Gartenberg \textit{v.} Merrill Lynch Asset Management, Inc.,\textsuperscript{11} two shareholders (Irving L. Gartenberg and Simone C. Andre) of a money market fund (Merrill Lynch Ready Assets Trust) “appeal[ed] from a judgment of the Southern District of New York.”\textsuperscript{12} That judgment had dismissed their consolidated derivative actions against Merrill Lynch Ready Assets Trust and its affiliates, Merrill Lynch Asset Management, Inc., the adviser and manager thereof, and Merrill Lynch, Pierce, Fenner & Smith, Inc.\textsuperscript{13} The principal claim on appeal was that the fees paid by Merrill Lynch Ready Assets Trust to Merrill Lynch

\textsuperscript{9} Id.
\textsuperscript{10} Id.
\textsuperscript{11} 694 F.2d 923 (2d Cir. 1982).
\textsuperscript{12} Id. at 925.
\textsuperscript{13} Id.
Asset Management, Inc., for varied services—encompassing investment advice and the processing of daily orders from fund shareholders—were so disproportionately large as to represent a breach of fiduciary duty violative of section 36(b) of the Investment Company Act of 1940. That provision had been added in 1970.

Section 36(b) in pertinent part provides:

For the purposes of this subsection, the investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser. An action may be brought under this subsection by the Commission, or by a security holder of such registered investment company on behalf of such company, against such investment adviser. With respect to any such action the following provisions shall apply:

(1) It shall not be necessary to allege or prove that any defendant engaged in personal misconduct, and the plaintiff shall have the burden of proving a breach of fiduciary duty.

(2) In any such action approval by the board of directors of such investment company of such compensation or payments, or of contracts or other arrangements providing for such compensation or payments, and ratification or approval of such compensation or payments, or of contracts or other arrangements providing for such compensation or payments, by the shareholders of such investment company, shall be given such consideration by the court as is deemed appropriate under all the circumstances.

Appellants contended that the district court had erred in its rejection of a reasonableness standard toward determining whether Merrill Lynch Asset Management, Inc. had executed its fiduciary duty in compliance with section 36(b). Additionally, they urged district court error in determining whether

14. Id. at 927; see 15 U.S.C. § 80a-35(b) (2006 & Supp. III 2010). “In 1960, the average expense ratio for a mutual fund was 0.48%, whereas now it stands at more than twice that amount at 0.98%.” Chuck Jaffe, Vanguard’s Bogle: Fix the Fund Industry, WALL ST. J., May 21, 2010, at C9.
16. Id. § 36(b).
17. Gartenberg, 694 F.2d at 927.
there had been a fiduciary duty breach in primary reliance upon other money market funds’ management fees level, and also on the costs to Merrill Lynch, Pierce, Fenner & Smith, Inc. They argued that the proper test must be the rate resultant from “arm’s-length negotiations in light of the services to be rendered.”

They argued further (as to such arm’s-length negotiated rate) that a fee percentage, which might have proved reasonable when Merrill Lynch Ready Assets Trust had been newly-launched, proved unreasonable once that trust had swelled to its then-huge size. Merrill Lynch Asset Management, Inc. charged the Merrill Lynch Ready Assets Trust an advisory fee hinging upon a proportion of the Fund’s net assets’ daily value. That fee graduated downward as the asset total waxed. Director of Mutual Fund Research for Morningstar, Russel Kinnel, acknowledged in 2010, in context of Jones, that a higher-cost fund might correspond with a higher-quality fund. Yet Kinnel so stipulated solely in terms of dollars expended upon managing, and not in terms of fees as a proportion of assets:

For example, Pimco Total Return, run by the estimable Bill Gross, charges annual management fees of 0.25%. But because the fund, the nation’s largest, holds some $200 billion in assets, Pimco clears about $500 million a year. Meanwhile, the middling Federated Bond charges a yearly management fee of 0.75%, which, on $1.1 billion in assets, generates fees of $8.3 million. So, does Federated charge triple Pimco’s management fee because its bond pickers are three times better than Pimco’s, or are the Federated folks less talented, as the huge gap between Pimco’s and Federated’s revenues implies? I’d say it’s the latter.

The fund industry says, rightly, that you can’t compare the fees of funds and separate institutional accounts because retail investors require more servicing. In many instances, however, a mutual fund’s management fee includes a kitchen sink’s worth of other charges, such as distribution costs, that aren’t used to pay investment professionals. Thus, investors and fund directors alike are in the dark when they compare fees, both between mutual

18. Id.
19. Id. at 928.
20. Id.
21. Id. at 926.
22. Gartenberg, 694 F.2d at 926.
23. Russel Kinnel, Fund Fees on Trial, Kiplinger’s Personal Fin., Feb. 2010, at 50.
funds and institutional accounts and among different mutual funds.24

Bear in mind that the fund management group Vanguard, alone among the biggest fund managers, is a mutual company.25 Thereby, that management company belongs, itself, to the funds it manages.26 Mutual funds are technically owned by the individual shareholders investing in them.27

All parties recognized, as had the district court, that the test essentially was to be whether the fee schedule instituted a change beyond the ambit of that which would have been reached—in light of all surrounding circumstances—via arm’s-length negotiation.28 The Gartenberg panel held that to be guilty of a section 36(b) violation “the adviser-manager must charge a fee . . . so disproportionately large that it bears no reasonable relationship to the ser-

24. Id. When weighted by mutual fund assets, the average fund’s expense ratio between 1951 and 2009 rose from 60% to some 87%. JOHN C. BOGLE, DON’T COUNT ON IT!: REFLECTIONS ON INVESTMENT ILLUSIONS, CAPITALISM, “MUTUAL” FUNDS, INDEXING, ENTREPRENEURSHIP, IDEALISM, AND HEROES 75 (2011). Fund managers arrogated to themselves the payoffs from the “economies of scale in managing other people’s money.” Id. at 150. There has been a central trio of corporate organization types in the financial services industry: public companies, the partnership, and the mutual. Ironically, supposedly was mutuality a structure finely-suited to providing common services and to the policing of self-regulation. Such a business was the more capable of eliciting and retaining a small customer’s trust. John Kay, How Trust in Finance Was Carried Off by the Carpetbaggers, FIN. TIMES (London), Jan. 19, 2011, at 11.

25. Id. Despite the “mutual fund” label attached to US investment funds, Vanguard is the only true mutual fund group, owned by investors in its funds. Naturally, Mr. [John] Bogle, [Vanguard founder], regards this as the best form of ownership. He claims support in this view from David Swensen, chief investment officer of Yale University’s endowment. He quotes Mr. Swensen: “Investors fare best with funds managed by not-for-profit organisations [sic], because the management firm focuses exclusively on serving investor interests.”

It is true in theory, but not always in practice, as investors in products managed by mutual life assurance companies discovered in the UK. That Vanguard has maintained its investor focus and stuck it its core principles probably has as much to do with Mr. Bogle’s strong views as with the mutual set-up. But more mutually run institutions would not go amiss. Mr. Bogle’s prescription for a better system is relatively simple: to demand proper fiduciary management from money managers. They must prioritise [sic] client interests, act as responsible corporate citizens, charge reasonable fees, and eliminate conflicts of interest.

26. Id.


28. Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 694 F.2d 923, 928 (2d Cir. 1982).
services rendered and could not have been the product of arm’s-length bargain-
ing.  

All pertinent facts were to be assessed. Not pertinent was the appellants’ proposal that a criterion for ascertaining fair advisory fees for money market funds (the captive funds) should be the lower fees levied by investment advisers upon large pension funds (independent clients):

The nature and extent of the services required by each type of fund differ sharply. As the district court recognized, the pension fund[s] do not face the myriad of daily purchases and redemptions throughout the nation which must be handled by the Fund, in which a purchaser may invest for only a few days.

During 2009, a panel for the United States Court of Appeals for the Eighth Circuit would suppose that this language constituted a Gartenberg disclaimer against comparing money market mutual funds (apples) against equity pension funds (oranges). And the Second Circuit panel concluded that the plaintiffs had failed to meet their burden of proving that the fees levied had been so extreme or unjust as to equal a breach of fiduciary duty under section 36(b).

Our affirmance is not a holding that the fee contract between the Fund and the Manager is fair and reasonable. We merely conclude that on this record appellants failed to prove by a preponderance of the evidence a breach of fiduciary duty. Whether a violation of [section] 36(b) might be established through more probative evidence of (1) the Broker’s processing costs; (2) the offsetting commission benefits realized by the Broker from non-Fund securities business generated by Fund accounts; and (3) the “float” interest income gained by the Broker from its method of handling payment on Fund redemptions, must therefore remain a matter of speculation. Indeed, the independent trustees of the Fund might well be advised, in the interests of Fund investors, to initiate such studies.

Hence, the judgment of the district court was affirmed.

29. Id.
30. Id. at 929.
31. Id. at 930 n.3.
32. Gallus, 561 F.3d at 823–24.
33. Gartenberg, 694 F.2d at 930.
34. Id. at 933.
35. Id. at 934.
Passage of the Investment Company Amendments Act of 1970, with its section 36(b), had little impact on the mutual fund industry. Section 36(b) spawned numerous lawsuits, but these met with piddling success. And into 2009, not only had the judiciary applied Gartenberg thinking for upwards of three decades, but the Securities and Exchange Commission had incorporated Gartenberg into its own rulemaking.

III. INTERLUDE: EASTERBROOK AND FISCHEL ON FIDUCIARY DUTY

A seminal article on fiduciary duty in general is Contract and Fiduciary Duty by Frank H. Easterbrook and Daniel R. Fischel. Previously, they had indicated that the duty of loyalty is a response to the impossibility of writing a contract specifying entirely the parties' obligations. One contracting party might "desire an objective... but have neither an idea nor much concern" about how her end be attained. In place of specified undertakings, an agent shoulders a loyalty duty respecting reaching the goal, plus a duty of care in performance. An expertise-hiring principal is reluctant to expose herself to the mercy of an agent whose inputs and outputs are difficult to monitor. This demarcates the fiduciary package.

Since Ronald H. Coase published his studies The Federal Communications Commission and The Problem of Social Cost in 1959 and 1960 re-

38. Id.
39. Gartenberg, 694 F.2d at 933.
43. Id. at 426.
44. Id.
45. Id.
46. Id.
47. Easterbrook & Fischel, supra note 42, at 426.
respectively, it has been grasped that the legal rules can minimize the challenges of fragmentary information and weighty transaction costs, via prescribing results contracting parties would have selected in a world of abundant information and costless negotiations. Transaction costs are those costs connected with utilizing a specific governance means to conduct transactions, e.g., the negotiation of, the formation of, and the monitoring of contracts, and enforcing performance. Coase first introduced into economics the transaction cost concept. Indeed, companies themselves arise when and where hierarchies provide superior to markets. A reason therefor is the expense in delineating and overseeing specific contracts. Rather than “detailed contracts, long-term relationships [built upon] trust need to emerge [within] businesses, and between businesses and suppliers.”

Fiduciary duties—Easterbrook and Fischel aver—are not a species apart from other contractual undertakings. Fiduciary obligations vary across different underlying transactions, just as do actual contracts vary across markets. Undeniably, fiduciary duties substantially deviate from one agency relationship to another: e.g., trustee/beneficiary, pension trustee/beneficiary, guardian/ward, attorney/client, partner/partner, corporate manager/investor, majority or inside investor/client, labor union/employee, lender/borrower, and franchisor/franchisee. On the other hand, Professor Robert Flanni-

50. See Easterbrook & Fischel, supra note 42, at 426. But, Easterbrook and Fischel cite only to the Coase article of 1960, not of 1959. See id. at 426.
52. Id.

When transactions are discrete and involve previously anonymous participants, contract doctrine reduces transaction costs by guaranteeing that the parties’ reasonable expectations will be met. By contrast, when transactions are ongoing, frequent, and involve close personal contact—when they are “relational,” in other words—the purpose and function of contract shift. Because norms are more likely to provide informal enforcement mechanisms, the benefits derived from ceremony and symbolism are at liberty to come to the fore.

54. Easterbrook & Fischel, supra note 42, at 427.
55. Id.
56. Id. at 432–34.
gan—the Canadian expert on the law and economics of fiduciary duty—argues that Easterbrook and Fischel err in asserting that fiduciary duty attributes so deviate among agency relationships. Constantly evolving is the fiduciary principle.

Scholars of noneconomic bent lack "a unifying approach to fiduciary duties because they" seek something special in fiduciary relationships; but, there is naught special—Easterbrook and Fischel aver—to be unearthed. Once transactions costs prove steep, somebody calls some contractual relations fiduciary; nevertheless, it is a continuum as Easterbrook and Fischel allege. (On the other hand, Flannigan points out regarding contract and the general law of fiduciary obligation: "There is no connection at all where they do not overlap (open access contractual arrangements, non-contractual fiduciary obligations)."

Contract law encompasses the principle of good faith in implementation, and good faith blurs into fiduciary duties. For the respective good faith, and fiduciary duty, concepts are alike a stab at approx-


58. Robert Flannigan, The Economics of Fiduciary Accountability, 32 DEL. J. CORP. L. 393, 421 (2007) [hereinafter Flannigan, The Economics of Fiduciary Accountability]. "Context determines whether opportunism is actionable as a fiduciary breach." Id. at 394. "No authorities are offered for the supposed attributes and many of those attributes are misleading or irrelevant." Id. at 421 n.121. The 1993 article was produced by, and was responsive to, discussions running throughout the 1980s over the suitability and relative efficacy of fiduciary and contract/market machinery to control managerial behavior. Id. at 422.


60. Easterbrook & Fischel, supra note 42, at 438.

61. See id.


63. Easterbrook & Fischel, supra note 42, at 438.
imating those terms parties would have negotiated had they anticipated the circumstances engendering their dispute.\textsuperscript{64}

Homilizing language in judicial opinions must not divert anyone\textsuperscript{65} from the hypothetical bargain insight.\textsuperscript{66} True, the remedy for violation of the fiduciary duty of loyalty—disgorgement of all profit obtained thereby—appears distinctly anti-contractual.\textsuperscript{67} Throughout contract law, the presumptive remedy is premised upon a promisee’s loss.\textsuperscript{68} On the other hand, today disgorgement remedies likely award a “promisee only the profit net of the opportunity cost incurred,” i.e., gross profits minus what the promisee could have obtained chasing alternative opportunities with equal time and effort. This is not “gross profits [minus] out-of-pocket expenses.”\textsuperscript{69} In short, if an actual contract is made, a judge enforces it.\textsuperscript{70} If actual contracts are feasible, then courts induce bargaining.\textsuperscript{71} If transaction costs weigh too heavily, then judges establish presumptive rules toward maximizing the parties’ joint welfare.\textsuperscript{72} Contract and fiduciary duties align along a continuum.\textsuperscript{73}

On the other hand, Flannigan points out that while default rules are public goods accessible to the citizenry to cut transaction costs generally, all default rules share this public good character.\textsuperscript{74} The function of fiduciary responsibility as a provision of a standard form set of terms to curtail transaction costs therefore presents a generic function, connecting to default status per se and with no specific content at any given form of legal regulation.\textsuperscript{75} So such function cannot constitute a “unique substantive rationale for fiduciary accountability.”\textsuperscript{76}

\begin{flushright}
\textsuperscript{64} Id. at 438 n.28. \\
\textsuperscript{65} See id. at 439–40. \\
\textsuperscript{66} Id. at 438. \\
\textsuperscript{67} Id. at 441. \\
\textsuperscript{68} Easterbrook & Fischel, supra note 42, at 441. \\
\textsuperscript{69} Id. (citing E. Allan Farnsworth, \textit{Your Loss or My Gain? The Dilemma of the Disgorgement Principle in Breach of Contract}, \textit{94 Yale L.J.} 1339, 1370–82 (1985)). \\
\textsuperscript{70} Id. at 446. \\
\textsuperscript{71} Id. \\
\textsuperscript{72} Id. \\
\textsuperscript{73} Easterbrook & Fischel, supra note 42, at 446. It is especially in the last thirty or forty years that transaction-cost economics has informed the investigation of multiple salient topics. See, e.g., \textit{The Elgar Companion to Transaction Cost Economics} (Peter G. Klein & Michael E. Sykuta eds., 2010). \\
\textsuperscript{74} Flannigan, \textit{The Economics of Fiduciary Accountability}, supra note 58, at 417. \\
\textsuperscript{75} Id. \\
\textsuperscript{76} Id. In any case, “[t]ransaction cost methodology [demands] the evaluation of relative costs. Economists [still] have yet to operationalize that methodology for” fiduciary duty law. Id. at 402–03 n.33 (citing Oliver E. Williamson, \textit{The Economics of Governance}, \textit{95 Am. Econ. Rev.} 1, 3–7 (2005)).
\end{flushright}
And the musings of Frank H. Easterbrook over fiduciary duty would later loom large over the Jones saga.

IV. **Jones v. Harris Associates L.P.**

In a May 19, 2008 opinion for a unanimous panel, including Circuit Judges Kanne and Evans, United States Court of Appeals for the Seventh Circuit Chief Justice Frank H. Easterbrook reviewed a district court conclusion that Harris Associates, adviser to the Oakmark complex of mutual funds, had not violated section 36(b) of the Investment Company Act, and the court grant summary judgment in Harris Associates, favor. The Oakmark complex’s open-end funds had grown in recent years because the net returns thereof had surpassed the market average, and the investment adviser’s remuneration had grown apace. In the Jones v. Harris Associates L.P. controversy, the plaintiffs—who held shares in several Oakmark funds, captive mutual funds—contended that Harris’ investment advisory fees were excessive.

What Chief Judge Easterbrook styled “the main event” of the appeal was these “plaintiffs’ contention that the adviser’s fees [had been] excessive.” The district court had followed Gartenberg, concluding that Harris “must prevail because its fees are ordinary.” Plaintiffs first asserted that Gartenberg should not be heeded because the Second Circuit depends too much upon market prices as its reasonable fees benchmark—for plaintiffs averred that fees are denominated incestuously instead of via competition. Second, plaintiffs proposed that should any market be invoked as a fee benchmark, it is the one for advisory services to unaffiliated institutional clients: independent clients. Plaintiffs asserted that Harris, like many in-

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78. Id. at 629.
80. Id.
81. 527 F.3d 627 (7th Cir. 2008).
82. Id. at 629.
83. Id. at 630.
84. Id.
85. Id. at 631.
86. Jones, 527 F.3d at 631.
87. Id.
vestment advisers, boasts institutional clients—e.g., pension funds—charged the less.\textsuperscript{88}

Judge Easterbrook retorted that “just as plaintiffs are skeptical of \textit{Gartenberg} because it relies too heavily on markets, we are skeptical about \textit{Gartenberg} because it relies too little on markets.”\textsuperscript{89} Essentially, \textit{Jones} disapproved the Second Circuit’s \textit{Gartenberg} arm’s-length negotiated rate approach.\textsuperscript{90}

A fiduciary duty differs from rate regulation. A fiduciary must make full disclosure and play no tricks but is not subject to a cap on compensation. The trustees (and in the end investors, who vote with their feet and dollars), rather than a judge or jury, determine how much advisory services are worth.\textsuperscript{91}

After all, to conjure with the fiduciary duty term is to summon up the law of trusts,\textsuperscript{92} “[a]nd the rule in trust law is straightforward: A trustee owes an obligation of candor in negotiation, and honesty in performance, but may negotiate in his own interest and accept what the settlor or governance institution agrees to pay.”\textsuperscript{93} On the other hand, Flannigan teaches:

\begin{quote}
[It] is a policy assertion that opportunism is sufficiently controlled by various markets. There is nothing intrinsically “economic” about that argument, or, to put it another way, nothing turns on the fact of its economic character or presentation. It is simply a policy argument about how we might regulate opportunism.\textsuperscript{94}
\end{quote}

Judge Easterbrook in \textit{Jones} elaborates:

\begin{quote}
Things work the same way for business corporations, which though not trusts are managed by persons who owe fiduciary duties of loyalty to investors. This does not prevent them from demanding substantial compensation and bargaining hard to get it. Publicly traded corporations use the same basic procedures as mutual funds: A committee of independent directors sets the top managers’ compensation. No court has held that this procedure implies judicial review for “reasonableness” of the resulting salary,
\end{quote}

\begin{flushleft}
\textsuperscript{88.} \textit{id.}  \\
\textsuperscript{89.} \textit{id.} at 632.  \\
\textsuperscript{90.} \textit{Jones}, 527 F.3d at 632.  \\
\textsuperscript{91.} \textit{id.}  \\
\textsuperscript{92.} \textit{id.}  \\
\textsuperscript{93.} \textit{id.} (citing \textsc{Restatement (Second) of Trusts} § 242 cmt. f (2009)).  \\
\textsuperscript{94.} Flannigan, \textit{The Economics of Fiduciary Accountability}, supra note 58, at 394.
\end{flushleft}
bonus, and stock options. These are constrained by competition in several markets—firms that pay too much to managers have trouble raising money, because net profits available for distribution to investors are lower, and these firms also suffer in product markets because they must charge more and consumers turn elsewhere. Competitive processes are imperfect but remain superior to a "just price" system administered by the judiciary. However weak competition may be at weeding out errors, the judicial process is worse—for judges can’t be turned out of office or have their salaries cut if they display poor business judgment.  

Bluntly: “Judicial price-setting does not accompany fiduciary duties.”

Prior to the development of economic science, people searched for the “just price” criterion. Only “gradually it came to be realized that there is no . . .

95. *Jones*, 527 F.3d at 632–33.

96. *Id.* at 633.


Several meanings are attributed to the expression ‘neo-Austrian economics.’ For the Böhm-Bawerkian stream of thought, represented by authors such as M. Faber and P. Bernholz, the central problem is that of offering a coherent and up-to-date formulation of [Eugen von] Böhm-Bawerk’s theory of capital and interest. For other economists the expression ‘neo-Austrian theory’ is associated not so much with a methodology or a specific doctrine as with an ultra-liberal ideology. For these, being neo-Austrian today means basically being in favour of the free market. It is mainly to Fritz Machlup (1902–83), and to his interpretation of the work and thought of von Mises, as presented in Knowledge: Its Creation, Distribution and Economic Significance (1980–83), that we owe the diffusion of this approach—an approach which in the last few years has received a great deal of attention from von Mises’ most fervent American follower, Murray Rothbard.

ERNESTO SCREPANTI & STEFANO ZAMAGNI, AN OUTLINE OF THE HISTORY OF ECONOMIC THOUGHT 389 (David Field trans., 2009).

As Friedrich Hayek might say liberalism fits the distributed knowledge of a creative social order. It does this because it gives autonomy to individuals and their own spontaneous, changing organizations. One might take such autonomy to be the central value of liberalism, or one might take the autonomy to be a means to other things, such as, especially, welfare. For Adam Smith, economic liberalism is justified as a way to enhance welfare through increased productivity. Blocking government intervention in the economy for capricious reasons makes almost all of us better off. Decentralization of knowledge implies two fundamentally important facts: popular ignorance and government ignorance. Given government’s ignorance of what it can actually accomplish in many realms, we must want it not to be empowered to act in those realms.
objectively determinable quantitative criterion of justice." Hence, Easterbrook’s scorn of a “just price” system administered judicially. During 2011, practically nobody explicitly searches for the so-called just price. Price as reflection of fair value is mythical. It generally is recognized that any ethical attack must be one against the consumers’ values; it is not to be leveled “against the quantitative price-structure [which] the market establishes on the basis” thereof. Given a pattern of consumer preferences, the just price is the market price. Economics cannot be value-free. However, once subjective values have been agreed upon, specific public policies can be pursued.

The incest protest of plaintiffs stemmed from the fact that an investment adviser creates the mutual fund, which the adviser then dominates despite “the statutory requirement[s] that 40% of trustees be disinterested.” Over the lifetime since the passage of the Investment Company Act of 1940, fund directors almost never fired their fund advisers. Hence Warren Buffett “scoffed at fund directors” at least as early as 1993. Few mutual funds ever change advisers, and [the Jones] plaintiffs concluded from this that the

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Hayek and the Austrian [S]chool of [E]conomics might better be seen as the Austrian school of social and political theory. The Austrian vision of distributed knowledge is consistent with John Stuart Mill’s grounding for his principle of liberty, that individuals have the best knowledge of what their interests are.


Future Soviet dissident Andrei Sakharov’s father, a physics teacher, JAY BERGMAN, MEETING THE DEMANDS OF REASON: THE LIFE AND THOUGHT OF ANDREI SAKHAROV 8 (2009), explained experiments to his son on the basis of scientific laws: “This was an idée fixe for Sakharov as a physicist and later as a dissident, when he believed that political problems were just as amenable as scientific ones to rational analysis.” Id. at 10. But rational analysis in politics, unlike physics, draws upon subjective, value-judgment premises. And are these likewise drawn upon in legal-economic theory, see, e.g., JAMES R. HACKNEY JR., UNDER COVER OF SCIENCE: AMERICAN LEGAL-ECONOMIC THEORY AND THE QUEST FOR OBJECTIVITY (2006), and in economics itself? See, e.g., JULIE A. NELSON, FEMINISM, OBJECTIVITY AND ECONOMICS (1996).

98. ROTHBARD, supra note 97, at 168–69.
99. Id. at 169.
100. See generally WILLIAM POUNDSTONE, PRICELESS: THE MYTH OF FAIR VALUE (AND HOW TO TAKE ADVANTAGE OF IT) (2010).
101. ROTHBARD, supra note 97, at 169.
102. Id.
105. FINK, supra note 37, at 188–89.
106. Id. at 189.
market for advisers is not competitive." However, Chief Judge Easterbrook countered that a fund’s investors themselves effectively fire advisers by shifting their money elsewhere. This they do once advisory fees become too onerous relative to results available from alternative investment vehicles: “It won’t do to reply that most investors are unsophisticated and don’t compare prices. The sophisticated investors who do shop create a competitive pressure that protects the rest.”

Does Easterbrook mean that an investment adviser as in Jones is off the hook because sophisticated outsiders who recognize that excessive adviser fees burden a captive mutual fund would accordingly withhold their own potential purchases, and thereby protect incumbent investors in that particular captive mutual fund via a threatened decline in the price of that captive mutual fund’s shares? The threatened decline in share price is, presumably, seen by Easterbrook as deterring excessive adviser fees. Assuredly, the law of large numbers so functions in democratic voting that even if some uninformed voters opt for incorrect choices, there obtains but slight prospect that the ultimate majority will opt otherwise than to a perfectly-informed majority’s result. Contrariwise, commercial comparisons cause complications, finds Donald A. Wittman:

The law of large numbers may explain the puzzle that the Bill of Rights protects free speech but not commercial advertising. False political advertising may fool a minority, yet it will have no harmful effect since votes for the minority will not be translated into political power. In contrast, a business does not have to persuade a majority of consumers, only a few, to have any sales. So the majority may want to protect a minority in the commercial arena.

107. Jones, 527 F.3d at 631.
108. Id. at 634.
109. Id.
110. Id. (citing Alan Schwartz & Louis L. Wilde, Imperfect Information in Markets for Contract Terms: The Examples of Warranties and Security Interests, 69 VA. L. REV. 1387 (1983)).
111. DONALD A. WITTMAN, THE MYTH OF DEMOCRATIC FAILURE: WHY POLITICAL INSTITUTIONS ARE EFFICIENT 16 (1995). Wittman’s example assumes voters’ errors to be uncorrelated. Id. However, similar results are yielded by more complex models. Id. (citing Krishna K. Ladha, Condorcet’s Jury Theorem in Light of de Finetti’s Theorem: Majority-Rule Voting With Correlated Votes, 10 SOC. CHOICE & WELFARE 69 (1993); Sven Berg, Condorcet’s Jury Theorem, Dependency Among Jurors, 10 SOC. CHOICE & WELFARE 87 (1993)).
112. WITTMAN, supra note 111, at 16–17. Again, why the difference in harmful effect between political and commercial markets? “The reason for the difference is that consumers get what they buy, but voters get what the majority ‘buys.’” POSNER, LAW, PRAGMATISM, AND
That is, a business—captive mutual fund—need not fool a majority of consumers—potential investors that include sophisticated outsiders—to profitably make its sales of sufficient fund-shares. So the majority of voters acting through Congress could want to protect from harmful effects uninformed consumers who buy shares of captive mutual funds in the commercial arena. That voter-majority’s protective shield would be section 36(b).

Flannigan points out as to fiduciary issues that a manager cannot credibly argue that her opportunistic benefits prove unobjectionable because the firm has implicitly consented thereto via accepting an opportunism discount.\(^\text{113}\) Such a discount "reflect[s] only the risk of opportunism," i.e., reflecting expanded monitoring costs.\(^\text{114}\) It is not justification of actual opportunism.\(^\text{115}\) The law can scarcely swallow the defense that liability is eliminated because the mischief could be foreseen.\(^\text{116}\)

\(\text{DEMOCRACY, supra note 97, at 192. Other differences between political and commercial markets favor the market. According to Milton Friedman, who in 1976 was awarded the Alfred Nobel Memorial Prize in Economics, BANNOCK ET. AL., supra note 49, at 166, the latter "is, in political terms, a system of proportional representation. Each man can vote, as it were, for the color of tie he wants and get it; he does not have to see what color the majority wants and then, if he is in the minority, submit." MILTON FRIEDMAN, CAPITALISM AND FREEDOM 15 (1962).}\)

\(\text{113. Flannigan, The Economics of Fiduciary Accountability, supra note 58, at 406.}\)

\(\text{114. Id.}\)


\(\text{116. Id. “In the narrow sense, agency costs are the costs of opportunism and the costs of controlling opportunism.” Id. at 397 n.12. In the United Kingdom as of 2011, the ease of giving away capital bases had actually shrunk the mutual sector among the forms of economic organization. For large loom the intimately-connected institutional issues of governance and of capital structure:}\)

\(\text{The public limited company is the dominant form of economic organisation because, imperfect though the resolution of these issues within that framework may be, they are nevertheless resolved. Most other organisational forms do not achieve scale or permanence because they lack capital and often have poor governance and less effective management. Mutu}\)

\(\text{als, which may seem to offer the best solution to these questions, have frequently experienced difficulties from either overcapitalisation or undercapitalisation; and the mutual sector has shrunk because legislation made it too easy to give capital bases away. The John Lewis Partnership, the poster child of the sector today, survives because John Spedan Lewis, its founder, was shrewed enough to make this virtually impossible.}\)

\(\text{John Kay, Time for the Big Society to Get Down to the Nitty-Gritty, FIN. TIMES (London), Feb. 23, 2011, at 9. Plain is the crux of the problem:}\)

\(\text{The critical governance requirement is to devise supervisory structures that include a sufficiently wide range of stakeholders to prevent capture by any particular interest. One common problem that hybrid organisations, including public companies, face is that they end up run mainly for the benefit of some particular group—employees, financiers, local politicians, or incumbent management.}\)

\(\text{Id. Does this special interest capture idea sound familiar?}\)
The unaffiliated institutional clients' fee benchmark proposal of plaintiffs, Chief Judge Easterbrook also swept aside:

Harris Associates charges a lower percentage of assets to other clients, but this does not imply that it must be charging too much to the Oakmark funds. Different clients call for different commitments of time. Pension funds have low (and predictable) turnover of assets. Mutual funds may grow or shrink quickly and must hold some assets in high-liquidity instruments to facilitate redemptions. That complicates an adviser's task. Joint costs likewise make it hard to draw inferences from fee levels. Some tasks in research, valuation, and portfolio design will have benefits for several clients. In competition those joint costs are apportioned among paying customers according to their elasticity of demand, not according to any rule of equal treatment.\footnote{117}

Such was the avalanche-momentum of the disclosure element in Judge Easterbrook's opinion that, the Harris fees being unhidden from investors, and there being no allegation "that Harris Associates pulled the wool over the eyes of the disinterested trustees" nor hindered trustees' capacity to negotiate a favorable advisory services price, the judgment of the district court was affirmed.\footnote{118} To be sure, the Easterbrook repudiation of an arm's-length negotiated rate standard acknowledged imaginable compensation—e.g., by a university's board of trustees to its president—"so unusual"\footnote{119} as a 25 to 1 multiple of that paid to other presidents that a court would infer either deceit, or abdication of responsibility.\footnote{120} Yet no court inquires whether salaries ordinary among comparable institutions mark excess.\footnote{121}

\footnote{117. Jones v. Harris Assocs. L.P., 527 F.3d 627, 634–35 (7th Cir. 2008), vacated by 130 S. Ct. 1418 (2010).}
\footnote{118. Id. at 635.}
\footnote{119. Id. at 632.}
\footnote{120. Id.}
V. THE GHOST OF JONES WALKS

An August 8, 2008,122 per curiam opinion from the Easterbrook, Kanne, and Evans panel announced that panel’s unanimous denial of a rehearing petition.123 A judge in active service had called for a vote on a suggested rehearing en banc.124 No Seventh Circuit majority had favored such en banc rehearing.125 Consequently, the rehearing petition was denied.126 Nevertheless, Circuit Judge Richard A. Posner, with whom Circuit Judges Rovner, Wood, Williams, and Tinder joined, dissented from the denial of rehearing en banc:127 “Jones is the only appellate opinion noted in Westlaw as disagreeing with Gartenberg; there is a slew of positive citations.”128 Indeed:

It’s not as if Gartenberg has proved to be too hard on fund advisers. “Subsequent litigation [after Gartenberg] in excessive fee cases has resulted almost uniformly in judgments for the defendants . . . although there have been . . . notable settlements wherein defendants have agreed to prospective reduction in the fee schedule.”129

A. The Law and Economics of Executive Compensation

Posner observes that the Easterbrook panel premised its repudiation of Gartenberg mainly upon an economic analysis ripe for reexamination.130 Scholarship probes the law and economics of corporate governance.131 Dissected is governance and executive compensation.132 Upon the long genera-

123. Id. at 729.
124. Id.
125. Id.
126. Id.
127. Jones, 537 F.3d at 729 (Posner, J., dissenting). “Circuit Judge Ripple did not participate in the consideration or decision of this case.” Id.
128. Id. at 729 (Posner, J., dissenting) (citing, inter alia, nine opinions).
129. Id. at 730 (Posner, J., dissenting) (quoting JAMES D. COX ET AL., SECURITIES REGULATION: CASES AND MATERIALS 1211 (3d ed. 2001)).
Gartenberg held that suits can succeed only if the fee is so high that it is outside the range of what parties might reasonably negotiate in an arm’s-length transaction (a fair transaction in which buyers and sellers have no relationship with one another). In nearly three decades under this standard, no fund company has ever lost a suit over fees.
Russel Kinnel, The High Court on Fees, KIPLINGER’S PERS. FIN., June 2010, at 49.
tion of 1980–2010, the free enterprise system bestowed a prosperity beyond any level hitherto seen.\textsuperscript{133} The market encouraged innovation and dazzled consumers with options.\textsuperscript{134} Nevertheless, the market for chief executives appeared dysfunctional.\textsuperscript{135} And the latest academic research indicates that at the margin those investing in start-ups ought to lay more weight on the business itself than its management team.\textsuperscript{136}

1. The Shareholders Snooze

Executives' remunerations fattened whatever the welfare or setbacks of their companies.\textsuperscript{137} The Posner dissent explains that indications accumulate that "executive compensation in large, publicly-traded firms often is excessive."\textsuperscript{138} Elsewhere Posner had recounted how corporate legal theory posits that a controlling shareholder owes a fiduciary obligation to minority shareholders.\textsuperscript{139} Meritorious is this theory in the case of conflict of interest emerging between the shareholder majority and the minority.\textsuperscript{140} Such, many agree, is the better view.\textsuperscript{141} Can a standard compensation-model explain the compensation of America's corporate CEOs?\textsuperscript{142} For they attract, on average, approximately double the compensation of their foreign counterparts.\textsuperscript{143}

\begin{enumerate}
\item \textsuperscript{134} \textit{Id.}
\item \textsuperscript{135} \textit{Id.}
\item \textsuperscript{136} Steven N. Kaplan et al., \textit{Should Investors Bet on the Jockey or the Horse? Evidence from the Evolution of Firms from Early Business Plans to Public Companies}, 64 J. FIN. 75, 75 (2009).
\item \textsuperscript{138} Jones v. Harris Assocs. L.P., 537 F.3d 728, 730 (7th Cir. 2008) (Posner, J., dissenting) (per curiam).
\item \textsuperscript{140} \textit{Id.}
\item \textsuperscript{141} The expert on the law of fiduciary duty, Tamar Frankel, agreed on this as the view to be preferred. Tamar Frankel, \textit{Fiduciary Duties}, in \textit{2 The New Palgrave Dictionary of Economics} 127, 129 (Peter Newman ed., 1998).
\item \textsuperscript{142} Posner, \textit{Economic Analysis of Law}, supra note 139, at 447.
\item \textsuperscript{143} \textit{Id.} In 2009, according to Income Data Services, the chief executives of the United Kingdom's 100 biggest companies earned eighty-one times the pay average of fulltime workers. John Plender, \textit{To Avoid the Backlash, Executives Need to Act on Pay}, FIN. TIMES (London), Apr. 3, 2010, at 7. In 2008, according to the Institute for Policy Studies, U.S. top executives earned 319 times more than did America's average worker. \textit{Id.}
\end{enumerate}
Yes, there is such an explanation: Stock ownership is less concentrated in the United States than it is abroad.\textsuperscript{144} Shareholders diversifying their portfolios—and able to sell their shares in liquid markets—sense slight impulse to assess or monitor company behavior.\textsuperscript{145} For the more money she has at stake, the weightier the incentive a shareholder perceives to monitor the performance of her firm’s management.\textsuperscript{146} And the more effective proves shareholder monitoring (the stick), the less the call for incentive-based compensation (the carrot) for a CEO.\textsuperscript{147} In widely-held public companies, failures of corporate governance inevitably crop up.\textsuperscript{148} It is in the United States where traditionally corporate governance has been weak, given denial of effective voice to shareholders and an unhealthy domination of boards by a combined chairman/CEO.\textsuperscript{149} Thereby could American CEO incomes grow porkier than would prove the case in a more competitive market for corporate managers.\textsuperscript{150}

For the burden on a major company of even gross overpayments to a CEO falls so lightly once spread across the shareholders—supposing a dispersed stock ownership—that no one shareholder has any incentive to react.\textsuperscript{151} And it is well-known that the strategy for the individual small inves-

\begin{footnotesize}
\textsuperscript{144} Posner, Economic Analysis of Law, supra note 139, at 447. Nevertheless, an ownership market (wherein individuals owned over ninety percent of the stock of U.S. corporations) is eclipsed by an agency market (wherein individuals hold but a quarter of such stock). John C. Bogle, Common Sense on Mutual Funds 352 (10th anniv. ed. 2010). Mutual funds, endowment funds, corporate, state and local pension funds, and other funds managed by professional investment organizations control about seventy-five percent of all U.S. corporate stock. \textit{Id.} This contrasts with only twenty percent in 1968. \textit{Id.}

\textsuperscript{145} Martin Wolf of the Financial Times states:

Shareholders enjoy limited liability. As a result, the responsibility they bear for the malfeasance or incompetence of management is highly circumscribed. The claim of shareholders is solely on the residual income of the company. But, since shareholders can diversify their portfolios with ease, their exposure to the risks generated by an individual company is far less than the exposure of workers with firm-specific knowledge and skills. Shareholders lack the ability to assess or monitor a company’s performance. If they are able to sell their shares in liquid markets, they do not have incentives to do so either. Failures of corporate governance in widely-held public companies are, it follows, inevitable.

Wolf, supra note 53.

\textsuperscript{146} Posner, Economic Analysis of Law, supra note 139, at 447.

\textsuperscript{147} \textit{Id.}

\textsuperscript{148} Wolf, supra note 53.


\textsuperscript{150} Posner, Economic Analysis of Law, supra note 139, at 447 (citing Lucian Bebchuk & Jesse Fried, Pay Without Performance: The Unfulfilled Promise of Executive Compensation 2 (2004)).

\textsuperscript{151} \textit{Id.} at 448.

Obviously no economist in the great classical tradition can either regret or deny profit maximization. And none can suppose that it is other than a deeply personal motivation, some-
\end{footnotesize}
tor of investing in index mutual funds indexed to, for example, the Standard & Poor's 500 Stock Index, has been extolled during the whole generation past.\textsuperscript{152} That strategy's merits were sung even after the anguishing October 2007–March 2009 U.S. stock market bust.\textsuperscript{153} Even in ideal times, successful shareholder protests are problematic.\textsuperscript{154} Moreover, should someone own personally, not through a mutual fund, one-hundred dollars of stock in each of 500 corporations, even a CEO stuffing himself with a titanic one percent of that enterprise's wealth costs that shareholder but a single dollar.\textsuperscript{155} So what happens to such a stockholder's reactive incentive?

Worse, should activist stockholders unite to rein their excessively generous board of directors, the proximate result could be an intracorporate succession crisis. Thereby are the intrepid shareholder-revolutionaries likely to be out of pocket for their insurrection. In the meantime, the stockholders in other corporations can benefit. For their own boards might witness that stockholder uprising, and therefore cinch their own belts a bit.\textsuperscript{156} No good deed goes unpunished.


\textsuperscript{153} \textit{Burton G. Malkiel & Charles D. Ellis, The Elements of Investing} 34–37 (2010).

\textsuperscript{154} \textit{Tim Harford, The Logic of Life}: \textit{The Rational Economics of an Irrational World} 107 (2008).

\textsuperscript{155} \textit{Id.}

\textsuperscript{156} \textit{Id.} at 108. Sure enough, mutual funds investing in corporate stock seemingly understand that stockholder activism to rein in an excessively generous board can backfire. For under the "Wall Street rule" a mutual fund merely sells its shares if that sophisticated investor dislikes a company's management. Editorial, \textit{Advisers Will Have Their Hands Full with the Reform Law}, \textit{Inv. News}, July 26, 2010, at 11.
On the other hand, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010,157 executed by President Barack H. Obama on July 21, provided of the Securities and Exchange Commission:

The Commission may issue rules permitting the use by a shareholder of proxy solicitation materials supplied by an issuer of securities for the purpose of nominating individuals to membership on the board of directors of the issuer, under such terms and conditions as the Commission determines are in the interests of shareholders and for the protection of investors.158

Thus, the Commission became empowered to allow investor nomination of directors, on corporate proxies mailed to shareholders, solely the companies’ own nominees appearing on such theretofore.159

2. The Directors Doze

The ordinary reactive incentive of the board of directors is weak if that board is dominated by heavily-remunerated business executives, including CEOs.160 According to Commissioner Troy A. Paredes of the Securities and Exchange Commission—speaking on his own behalf and not that of the Securities and Exchange Commission nor of his fellow Commissioners:

Boards of directors are expected to improve decision making by spurring deliberation. In acting as a body, the promise is that boards will draw on the distinct perspectives, experiences, sensibilities, and expertise that different directors offer. The expectation is that as the group works through a range of ideas and arguments, the ultimate decision will be better as a result of the directors’ collective efforts.

The active engagement of directors is a lynchpin of meaningful deliberation. Decision making should improve when directors—whether interacting with each other or with management—engage in open and frank discussions, even if it means being critical. When assessing some course of action, directors should ask probing questions and follow-ups of each other and of manage-

158. Id. at § 971(b).
160. POSNER, ECONOMIC ANALYSIS OF LAW, supra note 139, at 448.
ment; should challenge key assumptions; should offer competing analyses; and should develop competing options to ensure that alternatives are considered and not cast aside too readily. Put differently, directors should be willing to dissent, and disagreement from others should not be discouraged or suppressed. When it leads people to engage rigorously, disagreement helps ensure that the unknown is identified, that information is uncovered, and that challenges and opportunities are assessed in a more balanced way. Indeed, a board may want to consider designating one or two directors whose express charge is to be skeptical and to press when needed. 161

Paredes’ notion of directors being expressly charged to be skeptical was popularly bandied during the Jones Supreme Court of the United States litigation. 162 And, for megabanks commanding more than $100 billion in assets, accountable boards of super-directors have been proposed to implement customized executive compensation systems. 163 Such a little knot of inde-

161. Paredes, supra note 40.

Boards often have need of a devil’s advocate. But it shouldn’t always be the same person, and particularly not a director who was appointed because his or her views differ from the group’s. Anyone who always looks at issues critically may end up being typecast as an “oddball” or a “cynic” whose comments should not be taken too seriously.

One way around the problem is to choose a different director to play devil’s advocate at each meeting. The choice can depend on the issues to be discussed. Or ask for volunteers. This is also a way to help reluctant lone dissenters test whether others share their opinion.


[There will be a tendency to overestimate how likely or well supported a hypothesis is, in the absence of procedures designed specifically to call up and consider countervailing evidence. The evidence upon which we base our beliefs is not (in general) a random sample of the relevant evidence available to us or of the evidence that we already (in some sense) possess. A striking and salient presentation of some evidence will produce biases in the recall of other evidence and hence biases in the resulting beliefs. Hence, it is especially important in assessing a possible belief not merely to consider the evidence for and against that we have thought of but to make particular and systematic efforts to call up all the relevant evidence, for and against, that we have.


pendent directors would be added according to a model loosely founded upon the boards of companies under the control of private equity funds. For inherently feeble are broadly-based bars against executive compensation. So ingenious are lawyers in circumventing such restrictions that these seldom prove effective and occasionally prove counterproductive.

During 2010, Stanford University’s Kenneth J. Arrow—who in 1972 was awarded the Alfred Nobel Memorial Prize in Economics—judged that the most important innovation in economic theory during the two 1960–2010 generations had been its emphasis upon asymmetric information. Unfortunately, boards of directors are opaque entities, even to many institutional investors and corporate executives. Individual shareholders holding small positions know little who board members are. Too many board members, beholden to the CEO ship-captain who piped them aboard, fail to represent shareholder interests for that reason. The United Kingdom imposes nine-year term limits upon independent directors, to force board turnover. The value in reducing cronyism can outweigh the price in lost experience.

Moreover, a board employing a second-best CEO candidate—on the ground she would serve far more cheaply than would the foremost candidate—must expose itself to criticism should she come a cropper. Whereas the board covers its own assets by paying top dollar for the very best. Should that CEO fail, the directors will appear less blameworthy. Even competition in a corporation’s product and capital markets cannot constrain even managerial misconduct, which increases corporate costs.

164. Id. at 285.
165. Id. at 284.
166. Pozen, supra note 163, at 276.
167. Id.
169. Kenneth J. Arrow, Economic Theory and the Financial Crisis, in The Irrational Economist: Making Decisions in a Dangerous World 187 (Erwann Michel-Kerjan & Paul Slovic eds., 2010). “Insurance companies had long understood the consequences of asymmetry of information under such headings as moral hazard and adverse selection.” Id. at 188 (Arrow’s emphasis).
171. Id.
172. Id. at 5.
173. Id. at 263.
174. Id.
175. Posner, Economic Analysis of Law, supra note 139, at 448.
176. Id.
177. Id.
178. Id.
lem of agency costs inheres in the structure of any big enterprise, and is not eliminable through competition. 179

3. The Ideal of Fiduciary Duty

Nevertheless, Duke University economist Rachel E. Kranton and George A. Akerlof, who in 2001 was awarded the Alfred Nobel Memorial Prize in Economics, propound that the foremost consideration in an executive’s incentives could be her role as a fiduciary. 180 Given limited liability, an incentive to indulge in excess risk arises at once. The heavier a gamble, the more stockholders look to gain should the roulette wheel rest upon their color. Should their bet fail, the larger losses accrue to their corporation’s creditors alone once shareholders’ equity is exhausted. 181 And a pay for performance scheme attracts, ominously, risktakers. 182 Self-sorting alters the ratios of various personality types found in various activities. Businessper-


Executive compensation differs substantially among firms and has changed dramatically over time. Bebchuk and Fried provide no explanation of those differences or changes. They tell a plausible story that corporate executives have some managerial power, but they make no case that the differences in executive compensation are explained by the unmeasured differences in board compliance and the limits on compensation that would not provoke outrage, either among firms or over time. In summary, there is no reliable body of evidence that is consistent with substantial managerial power over their own compensation, and the managerial power perspective provides no explanation of the substantial differences in executive compensation among firms or over time.


181. Benjamin M. Friedman, Two Roads to Our Financial Catastrophe, N.Y. Rev., Apr. 29, 2010, at 27, 27. Nobel laureate Joseph Stiglitz was asked: “Are the financial reforms now being debated in Congress strong enough to prevent the next crisis?” His reply, inter alia, ran:

Another big issue is bonuses and incentives. We’ve been reluctant to take the kind of strong measures that the United Kingdom has taken [such as heavy taxation of bonus payments]. Incentives matter. They affect behavior, and they can encourage excessive risk taking.


sons are more probably optimists than are librarians. Inside an investment company, traders tend to be the optimists but risk managers the pessimists.

A firm might be bankrupted, and an executive can be—at worst—dismissed if she has committed no fraud. Extra bonuses rewarding her for performance during the sunny days go unreayed during subsequent wintry times. Therefore, risky investments which are profitless socially—i.e., of a negative anticipated value, or of a positive anticipated value inadequate to recompense for a market-determined risk value—can be privately rational for a decision maker: She need not bear the entirety of those negative consequences she lays upon others. Fact-patterns wherein marketplace rational self-interest elicits socially irrational outcomes are termed cases of "rational irrationality."

Also, during a classic bubble, an asset can command a price steeply above its fundamentals—e.g., the discounted present value of the imputed rents of a house—for so long as that price is anticipated to soar the higher.

183. POSNER, LAW, PRAGMATISM, AND DEMOCRACY, supra note 151, at 296.
184. Id. Cf. NICK TASLER, THE IMPULSE FACTOR: WHY SOME OF US PLAY IT SAFE AND OTHERS RISK IT ALL (2008). Sure enough, when head of risk at Lehman Brothers Madeline Antoncic in 2006 suggested that declining housing prices could mean the balance sheet should come down, President and Chief Operating Officer, Joseph M. "Joe" Gregory, told her she was not only too fussy but out of line. VICKY WARD, THE DEVIL'S CASINO: FRIENDSHIP, BETRAYAL, AND THE HIGH STAKES GAMES PLAYED INSIDE LEHMAN BROTHERS 159 (2010). The general directive from Gregory was "do as much business as you can; take risk." Id.

It is hard to think of business activities with cultures as different as those of retail and investment banking. The former is intrinsically bureaucratic and hierarchical, relying on the accurate processing of millions of transactions every day with an infinitesimal proportion of errors. It is done best by people who empathise [sic] with their customers. The latter is naturally buccaneering and entrepreneurial; the people who do it best are aggressive and self-centered. Successful retail banking is based on relationships; modern investment banking is based on transactions.

John Kay, We Must Press on with Breaking up Banks, FIN. TIMES (London), Sept. 15, 2010, at 11.

185. Arrow, supra note 169, at 190. In the view of George Mason University economist Russell Roberts:

The expectation by creditors that they might be rescued allows financial institutions to substitute borrowed money for their own capital even as they make riskier and riskier investments. Because of the large amounts of leverage—the use of debt rather than equity—executives can more easily generate short-term profits that justify large compensation. While executives endure some of the pain if short-term gains become losses in the long run, the downside risk to the decision-makers turns out to be surprisingly small, while the upside gains can be enormous. Taxpayers ultimately bear much of the downside risk. Until we recognize the pernicious incentives created by the persistent rescue of creditors, no regulatory reform is likely to succeed.


But as prices zoom ever higher beyond their asset's fundamentals, investors—to make sense of increasingly-crazy prices—expect them to inflate at still speedier rates. Competitive pressures in a bubble impel a financier to bet rationally—particularly while gambling her diversified investors' money. Short term business horizons translate into the NIMTOF attitude: Not In My Term of Office. Before 2008, the temptation of hefty annual bonuses deterred persons from hedging their bets or weighing the chances of a financial meltdown, such as that transpiring in October 2008.

In one reading, pay for performance demonstrates mala fides. It informs the employee that she is not trusted to choose the right thing. Anyway, undiscovered remains the equation for quantifying bonuses and stock options to correspond with the correct incentive. There is no crystal ball.

Do not CEOs manipulate matters like inventories, collections, or payments, to monkey with quarterly earnings, and so manipulate their stocks' price, whereby to see options issued at bargain-basement prices? The proper incentive, conclude Kranton and Akerlof, should be to live up to her respon-


188. See POSNER, THE CRISIS OF CAPITALIST DEMOCRACY, supra note 151, at 32.


190. AKERLOF & KRANTON, supra note 182.


More than anything else, stock-based incentive compensation is responsible for short-termism in the modern corporation and the shrinking average tenure of today's chief executives. It is an incentive for manipulating expectations rather than improving real performance.

The solution is to replace stock-based compensation with incentives that affect underlying value—whether that is increasing revenues, profitability, market share, customer service or, optimally, a combination of all of these. And for longer-term incentives based on the actual market not the expectations market, use royalties on real results, as are given to designers, inventors and musicians. The bottom line is that if you want to skew reality, use stock-based compensation. But if you want to build the real company, use incentive compensation anchored in reality-based measures.

Roger Martin, Reward Real Growth, Not Expectations, FIN. TIMES (London), Aug. 3, 2010, at 10. Comparably, Graef Crystal, the compensation consulting pioneer, "recommends awarding stock options with a strike price that's the average of the last 90 days and can't be exercised for five years to avoid 'opportunistic' pricing." Jessica Silver-Greenberg and Alexis Leondis, How Much Is a CEO Worth?, BLOOMBERG BUSINESSWEEK, May 10–16, 2010, at 70.
sibilities. To be sure, entirely self-interested behavior can be abjured in lieu of a sense of fiduciary responsibility, even independently of a sense of identification with others. Opines Amartya Sen:

It must, of course, be recognized that the rejection of purely self-interested behavior does not indicate that one’s actions are necessarily influenced by a sense of identity with others. It is quite possible that a person’s behavior may be swayed by other types of considerations, such as her adherence to some norms of acceptable conduct (such as financial honesty or a sense of fairness), or by her sense of duty—or fiduciary responsibility—toward others with whom one does not identify in any obvious sense. Nevertheless, a sense of identity with others can be a very important—and rather complex—influence on one’s behavior which can easily go against narrowly self-interested conduct.

Affirmatively, as framed by Kranton and Akerlof: “In the financial world, it is called fiduciary duty. It is an obligation to serve the client and the larger good of an organization.” Negatively: “Acting in your own interest and not in the interest of clients is a failure to carry out the duties of office, to fulfill one’s fiduciary duty.”

And the language of fiduciary duty is the language of the Harris Associates fees.

B. The Law and Economics of the Harris Associates Fees

In 2009, the distinguished economist Thomas Sowell fumed that many intellectuals:

find it a weighty consideration that they do not understand how corporate executives can be worth such high salaries as they receive—as if there is any inherent reason why third parties should

192. Akerlof & Kranton, supra note 182. Whatever the incentive, some people are self-motivated. Or, as articulated in a didactic novel by Ralph Nader, the famed consumer protection lawyer: “That’s what successful, self-made people of wealth are like . . . . They are chronically averse to procrastination—one definition of an entrepreneur is someone who never does anything today that could have been done yesterday—and that trait alone gives them a major advantage over their competent but slower-paced peers.” RALPH NADER, ONLY THE SUPER-RICH CAN SAVE US! 79 (2009).


194. Id. Amartya Sen was awarded the Alfred Nobel Memorial Prize in Economics in 1998.

195. Akerlof & Kranton, supra note 182.

196. Id.
be expected to understand, or why their understanding or acquiescence should be necessary, in order for those who are directly involved in hiring and paying corporate executives to proceed on the basis of their own knowledge and experience, in a matter in which they have a stake and intellectuals do not. 197

Supposing that Sowell’s belittling of intellectuals’ digs against corporate executives’ salaries is meritorious, this line of thought cannot be dispositive of the legal profession’s scrutinizing of the compensation collected by the advisers of registered investment companies. For Section 36(b) lays a special fiduciary duty upon such advisers. And Section 36(b) further deputizes the security holders of such registered investment companies (“third parties”) to litigate against said investment advisers. Section 36(b) endures in a financial-regulatory world rocked by the first great recession of the twentieth century. 198 Therein do fiduciary finance institutions of 2011 like collective investment vehicles emerge beside insurers and banks as a pillar of the world’s financial system. 199

1. The Competition Conundrum

Truly, the functioning of investment firms entailing information asymmetries might evoke regulation insulating investors from incompetence and fraud. 200 In such respect the regulation of portfolio management displays affinity with regulation of the free professions. 201 Specifically, opportunistic behavior often being facilitated through asymmetric information, regulators avowedly defend consumers from excessive prices extracted by financial

198. See, e.g., THE FIRST GREAT RECESSION OF THE 21ST CENTURY (Oscar Dejuán, Eladio Febro, & Maria Christina Marcuzzo eds., 2011); THE FINANCIAL CRISIS AND THE REGULATION OF FINANCE (Christopher J. Green, Eric J. Pentecost & Tom Weyman-Jones eds., 2011); FINANCIAL STABILITY (Charles A.E. Goodhart & Dimitrios P. Tsomocos eds., 2011); THE FINANCIAL AND ECONOMIC CRISIS: AN INTERNATIONAL PERSPECTIVE (Benton E. Gup ed., 2010). The 2007-09 Great Recession exposed more than the fragility in the financial markets. See, e.g., FINANCIAL MARKETS AND FINANCIAL FRAGILITY (Jan Toporowski ed., 2010). For, as scholars hearkened, it likewise evoked questions about the adequacy of modern macroeconomic theory and about a seeming parallel incapacity to establish the requisite theoretical basis underlying financial regulation. See, e.g., MACROECONOMIC THEORY AND ITS FAILINGS: ALTERNATIVE PERSPECTIVES ON THE GLOBAL FINANCIAL CRISIS (Steven Kates ed., 2010).
201. Id.
service producers and other financial market participants. And in this regard regulation addresses not systemic stability, but the efficiency and integrity of the financial markets. In sum, the central notions are opportunism, asymmetric information problems, agency problems, and fiduciary duty.

Anyway, "[c]ompetition in product and capital markets can’t be counted on to solve" compensation challenges. Both legal scholars and economists feel aversion to monopoly and so favor competition, generally. However, exactly why is competition welcomed and monopoly scorned? Because competition guarantees alternatives, whereas monopoly precludes alternatives. Presence of alternatives checks competitive market firms from gross misallocation of resources, while monopolistic exploitation of resources waxes inefficient. Remember that regulators address the efficiency of financial markets.

Still, competition in product and capital markets falters since an identical structure of incentives emerges in all big corporations and similar entities, e.g., mutual funds. Long preceding the February 27, 2007, District Court opinion in Jones had the mutual fund industry been dominated by a handful of corporations. And does the bracing discipline of additional competitors trigger more intensive competitor-effort and improved service? Surprisingly, in at least some contexts the reply is not congruent with the professional intuition. The impact of competition proves an unsettled topic even regarding pricing.

202. Id. at 965.
203. Id.
206. Id.
207. Id.
208. Id.
209. Jones, 537 F.3d at 730.
213. Id.
214. Id. It was the University of Hamburg’s Institute of Law and Economics’ Ingo C. Fiedler whose scholarship most recently probed the merits of two-sided competition. See Ingo
Notably, Posner’s special concern in *Jones* lies in Harris’ charging captive funds over double its charges to independent funds.\textsuperscript{215} “The panel opinion throws out some suggestions on why this difference may be justified, but the suggestions are offered purely as speculation, rather than anything having an evidentiary or empirical basis.”\textsuperscript{216} Judge Posner sarcastically could have quoted to Easterbrook from the Epistles of Saint Paul: “Now faith is the substance of things hoped for, the evidence of things not seen.”\textsuperscript{217} For eye-popping was a 2009 study by the New York University Stern School of Business’ Thomas Philippon and Ariell Reshef of the University of Virginia’s Department of Economics.\textsuperscript{218} They utilized detailed data about wages, education and occupations toward explaining the U.S. financial sector.\textsuperscript{219} Wages in finance were excessive from the mid-1990s until 2006.\textsuperscript{220} For that interval, rents accounted for an estimated thirty to fifty percent of the wage differential between the financial sector and the balance of the private sector.\textsuperscript{221} Rentseeking is *inter alia*, a socially costly wealth transfer.\textsuperscript{222} Posner’s dissent cites Professor Camelia M. Kuhnen’s observation that “‘when directors and the management are more connected, advisers capture more rents and are monitored by the board less intensely.’”\textsuperscript{223} Kuhnen might bitingly have quoted from the Gospel of Saint Matthew: “Consider the lilies of the field, how they grow; they toil not, neither do they spin: And yet I say unto you, That even Solomon in all his glory was not arrayed like one of these.”\textsuperscript{224} To the extent they reap rents, nattily clad advisers toil not.

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\textsuperscript{216} *Jones v. Harris Assocs. L.P.*, 537 F.3d 728, 731 (7th Cir. 2008) (Posner, J., dissenting) (per curiam).

\textsuperscript{217} *Id.*

\textsuperscript{218} *Hebrews* 11:1 (King James).

\textsuperscript{219} *Id.* at 6.

\textsuperscript{220} *Id.* at 5.

\textsuperscript{221} *Id.* at 30.


\textsuperscript{224} *Matthew* 6:28–29 (King James).
2. Price Discrimination

Too, Posner elsewhere had addressed the seriousness of information deficiencies in ordinary markets. Most consumers prove to be uncareful shoppers. Some even suppose price a sign of quality. If half of consumers are well-informed but half not, then the latter will make numerous errors and suffer loss of utility. Yet these errors are minimized because the uninformed are somewhat protected by the informed. This latter phenomenon emerges because a seller usually cannot easily discriminate between these two blocs. Recall how Chief Judge Easterbrook reassured one that sophisticated investors shopping among alternative investment vehicles generate competitive pressure protective of the less sophisticated investors.

Several conditions must obtain for price discrimination to prove profitable. Initially, there must be such market segregation as to preclude arbi-

226. Id. at 219. Scholars of everyday applied-economics, see, e.g., Tim Harford, The Undercover Economist: Exposing Why the Rich Are Rich, the Poor Are Poor—And Why You Can Never Buy a Decent Used Car! (2006), descry a method in such consumer madness: Price changes the very experience of quality. “Neuro-economists have found, for instance, that while placebo painkillers work, they work best if the subject thinks they are expensive. Energy drinks give you less energy if you buy them at a discount. And wine tastes better if you believe that it is expensive.” Tim Harford, Dear Economist: Resolving Readers’ Dilemmas With the Tools of Adam Smith, Fin. Times (London), Jan. 30, 2010, at 2. How might these neuro-economic findings be explicable? Yale psychologist Professor Paul Bloom propounds essentialism as the notion that what truly counts is the underlying (not superficial) reality of a thing. Paul Bloom, How Pleasure Works: The New Science of Why We Like What We Like 9 (2010). It consequently matters whether artwork is an original Picasso. Id. at 119-20. Human beings are born-essentialists. Id. at xii. For typically do art, sports, games, music, etc., display such reproductively-relevant capacities as intelligence. People’s essentialism could emerge as their attraction to a performance’s underlying history, due to their pleasure derivative from its display of natural gifts. Id. at 154.
227. Posner, Law, Pragmatism, and Democracy, supra note 97, at 192. In the appraisal of S.C. Johnson Distinguished Professor of International Marketing Philip Kotler at Northwestern University’s Kellogg School of Management:

Most economists emphasize the role of price in determining choice, to the neglect of other major forces such as advertising, sales promotion and sales personnel that shape and motivate consumer and business behaviour. My argument has been that besides macro and micro economics, economists must add “market economics” (ie, marketing) to the study of how the market place actually works. This advance is already being reflected in the rise of “behavioural economics.”

trage—i.e., buyers in one market cannot resell into another. Second, a seller must command some monopolistic power in a minimum of one market because, given competition, prices will be pressed to the cost-level. Third, buyers in different markets must evince different elasticities of demand. Sales rise to the higher prices in markets wherein elasticity is low. The latter explains the willingness of consumers in a first market to pay more than the consumers in a second market without the seller losing sales in that second market. Under perfect price discrimination, a different price is chargeable to each customer.

More specifically, under what is denominated third degree price discrimination, sellers allot buyers into classes in accordance with those buyers’ demand for elasticity, a different price being extracted from each group. Implausible though it might sound, the real world is abrim with discounted-price products which actually were more expensive to manufacture than their full-price counterparts. This dual-marketing nevertheless makes sense insofar as it smooths a producer’s targeting of its price-increases at a block of consumers most willing to pay, i.e., for those full-price counterparts.
Most enterprises set prices to attract customers and goose the bottomline; it is traditional to gouge the loyal customers. The solitary recognized justification for rewarding fealty is to create it where previously it was nonexistent.\textsuperscript{238} Such is the lesson of elasticity.

Apply to Jones the three conditions for profitable price discrimination. Are the effective buyers of Jones independent funds unable to arbitrage—viz., to resell to the captive funds’ effective buyers? Yes. Second, does Harris Associates command some monopolistic power in one market? Yes, evidence suggests. The Seventh Circuit panel merely speculated over why Harris charges captive funds over twice its charges to independent funds. Third, do different Harris customers evince different elasticities of demand? Yes, evidence might suggest. Posner muses over the Jones panel assurance that advisers cannot harvest money from captive funds if Himalayan fees drive off investors: “That’s true; but will high fees drive investors away?”\textsuperscript{239}

More specifically, respecting this third condition for price discrimination, customers cannot for fear of the higher price be expected to volunteer their low elasticity. Consequently, sellers seek something observable and correlated with this hidden demand characteristic, low elasticity\textsuperscript{240} Sure enough, experimentation has tested why individuals invest in high-fee index funds—there being a broad variation of fees in the universe of S&P 500 index funds. It reveals that even if such funds are reduced to commodities—i.e., stripped of non-portfolio services—subjects overwhelmingly fail to minimize fees, due to their own financial illiteracy.\textsuperscript{241} It proves this “individual,” by contrast with “institutional” feature of investors in a captive mutual fund, demarcates in itself a financially illiterate and thus easily-fleeced flock with low elasticity of demand. So how protected are the less-informed consumers of investment products by the better-informed investors’ competitive pressure? Imaginably, less-informed consumers are so ill-protected by com-


\textsuperscript{239} Jones v. Harris Assocs. L.P., 537 F.3d 728, 731 (7th Cir. 2008) (Posner, J., dissenting) (per curiam).

\textsuperscript{240} Donald E. Campbell, Incentives: Motivation and the Economics of Information 257 (2d ed. 2006).  

petitive pressure that the majority of voters summoned the section 36(b) pro-
tection of the ill-informed (as suggested in Sec. IV, supra), such are the va-
garies of contract law and economics. 242

3. Informational Disclosure

Nor are the perplexities of befuddled mutual fund investors necessarily
to be resolved by informational disclosure. In the assessment of Loyola Law
School of Los Angeles Professor Lauren E. Willis:

In addition to arithmetic manipulation of data, determining the
expected value of many financial choices requires assessing in-
formation reliability and interpreting results. The skills needed to
take data about the past and information about the future and pre-
dict the probabilities of future events and confidence intervals for
those probabilities are elusive for even sophisticated consumers.
Becoming a Certified Financial Planner therefore requires a pro-
gram of study that includes financial planning, risk management
and insurance, estate planning, retirement planning, employee
benefits, investments and individual income tax, three years of re-
levant experience, a ten-hour exam that requires an integrated ap-
lication of skills and knowledge to particular client situations, and
thirty hours of continuing education every two years to maintain
the credential. Consumers must acquire not only the particular
knowledge and skills described above, but also the ability to em-
ploy all of them at once. 243

Human capital resources most efficiently are exploited when persons
perform tasks for which they are best-fitted by predilection or training.
People generally decline to serve as their own attorneys or physicians and for
division of labor efficiency alone should decline, generally, from serving as

243. Lauren E. Willis, Against Financial-Literacy Education, 94 IOWA L. REV. 197, 224
(2008) (footnotes omitted). Willis' proves a "powerful" article. See Michael Skapinker,
enough, a mid-2010 review of Australia's 17 year-old mandatory defined contribution pension
system declared that "'member-driven competition through choice of fund has struggled to
deliver a competitive market that reduces costs for members.'" Pauline Skypala, How to Put
Scheme Members First, FIN. TIMES (London), July 12, 2010, at 6 (quoting a recent review of
the Australian system). The report discovered participants to be less rational or informed than
had been assumed. Id. Hence, regulators cannot depend on disclosure and market pressures
to control that costly, inefficient system. Id.
their own financial planner.244 The staggering expenditure of energy and
time required for someone of average literacy to strive seriously to become
her own financial planner could easily yield a grander welfare return when
invested elsewhere.245

Or, in the words of Commissioner Paredes:

It also is possible for there simply to be too much information for
investors and others to work through constructively. The risk of
"information overload," in other words, is a cost of mandatory dis-
closure. Investors today are inundated with volumes of informa-
tion, so much so they sometimes are unable to distinguish what is
important to their decision making from what is not. As a result,
investors too frequently do not bother carefully studying the in-
formation that is available and get overwhelmed or distracted,
misplacing their focus on less important matters. In short, the
sheer amount of information can frustrate its effective use. The
trouble is that when information is not processed and interpreted
effectively, disclosure does not translate into better decision mak-
ing. Ironically, if investors are overloaded, more disclosure actual-
ly can result in less transparency and worse decisions.246

244. Willis, supra note 243, at 263–64. David Hume wrote maladroitly: "By the partition
of employments, our ability increases: ..." DAVID HUME, TREATISE OF HUMAN NATURE 485
(1992). Hume consequently lost paternity for the modern division of labor phraseology to
Adam Smith. HARDIN, supra note 97, at 10 n.5. The division of labor prevails because it
uncages the economy of scale. HARFORD, supra note 154, at 81. "It is a harsh truth about the
world of work that for many professionals, the more work you have done in the past, the more
productive each additional working hour becomes: a perfect example of economies of scale."
Id. The division of labor mandates professional financial planners, not self-helpers. See id.

But consumers don't even know what a financial planner does. See Sheila McClune,
Consumers Still Unsure About What Financial Planners Do, RESEARCH SPOTLIGHT, Second
Quarter 2010, at 4. And if professional planners are too pricey for the masses, can the gap be
filled by web-based money management? George Mannes, The Future of Investing Advice,
MONEY, June 2010, at 104. "MyMoney.gov is the U.S. government's website dedicated to
teaching all Americans the basics about financial education." MYMONEY,
help from over 20 different Federal web sites in one place." Id. In 2009, this site only
garnered approximately 85,000 hits monthly. Karen Blumenthal, Is There a Cure for Finan-
cial Illiteracy?, WALL. ST. J., June 19–20, 2010, at B8. But more hopeful is the recent startup,
Veritat Advisers, an online financial planning service. Jason Zweig, Screen Savers: Will
Online Financial Planning Catch on?, WALL. ST. J., Aug. 7–8, 2010, at B7. Thanks to auto-
mation, Certified Financial PlannerTM Tom Mooney at Veritat thinks he can serve 1,000
clients per annum. Id.

245. Willis, supra note 243, at 264.

246. Troy A. Paredes, Comm'r, U.S. Sec. & Exch. Comm'n, Remarks Before the Sympo-
sium on "The Past, Present, and Future of the SEC" (Oct. 16, 2009), (transcript available at
As more theoretically clarified by Herbert A. Simon—who in 1978 was awarded the Alfred Nobel Memorial Prize in Economics:

"[Given] an information-rich world, the wealth of information means a dearth of something else: a scarcity of whatever it is that information consumes. What information consumes is rather obvious: it consumes the attention of its recipients. Hence a wealth of information creates a poverty of attention and a need to allocate that attention efficiently among the overabundance of information sources . . . ."

The genuine bottleneck is the attention-time of human decision makers using incoming data.

The authentic design difficulty is not providing people with more information. It is allotting the time people have available for digesting data so decision makers will consume only such data as is most relevant and important to their decisions.

For attention, being scarce, is
precious: 251 “Scarcity of attention in an information-rich world can be measured in terms of a human executive’s time.”252 Hence, the well-known disutility of data dumps.

Posner did recognize the Easterbrook “so unusual” compensation level triggering a judicial inference of deceit, or of abdication.253 Unfortunately, “The panel’s ‘so unusual’ standard is to be applied solely by comparing the adviser’s fee with the fees charged by other mutual fund advisers.”254 Understand: “The governance structure that enables mutual fund advisers to charge exorbitant fees is industry-wide, so the panel’s comparability approach would if widely followed allow those fees to become the industry’s floor.”255

C. The Citizenry Seethed While the Judiciary Pondered

Especially because of Judge Posner’s connection of mutual fund adviser fees to executive compensation, his dissent was attended-to in corporate

251. SIMON, supra note 248, at 48. Is there any escape from informational pitfalls menacing even the most sophisticated investors riding the most elaborate computational machinery? A study by Sanjeev Arora and Boaz Barak both of the Princeton U. Computer Science Department and Center for Computational Intractability, Markus Brunnermeier of Princeton’s Department of Economics and Bendheim Center for Finance, and Rong Ge of the Department of Computer Science and Center for Computer Intractability realized that most analyses of the 2007-2009 financial crises blamed faulty models in pricing derivatives. Yet that evokes the question of whether a more precise model would prove prophylactic against future problems. Seemingly, will such pricing problems endure even given superior models? The pricing problem should grow more difficult for more complicated models.

Traditional economics argues that financial derivatives ameliorate the costs inflicted by asymmetric information: Alas, using theoretical computer science modes, these authors argue that derivatives actually can amplify asymmetric information costs. Sanjeev Arora et al., Computational Complexity and Information Asymmetry in Financial Products 12 (Oct. 19, 2009) (unpublished working paper), available at www.cs.princeton.edu/~rongge/derivative.pdf. “Note that computational complexity is only a small departure from full rationality since even highly sophisticated investors are boundedly rational due to a lack of requisite computational resources.” Id. at 1.


254. Id.

255. Id. “And in this case there was an alternative comparison, rejected by the panel on the basis of airy speculation—comparison of the fees that Harris charges independent funds with the much higher fees that it charges the funds [that] it controls.” Id.
The Jones controversy came to a boil amidst national debate over whether the market can be entrusted with naming the pay rates of corporate executives. And excesses in compensation of the financial executives crucially inflamed the populace after the stock market meltdown climaxing in March, 2009. A political tempest concerning Goldman Sachs' 2009 compensation preceded a still-roiling public ire over executive compensation in 2010. Between the Supreme Court oral argument in Jones and the issuance of the Supreme Court’s opinion in Jones, President Obama remarked in an interview on February 9, 2010, concerning Goldman Sachs CEO Lloyd Blankfein and J.P. Morgan CEO Jamie Dimon:

Let’s talk bonuses for a minute. Lloyd Blankfein: $9 million. Jamie Dimon: $17 million. Now, those were in stock and less than what some had expected. But are those numbers O.K.? First of all, I know both those guys. They are very savvy businessmen. And I, like most of the American people, don’t begrudge people’s success or wealth. That is part of the free-market system.

I do think that the compensation packages that we have seen over the last decade, at least, have not matched up always to performance. I think that shareholders oftentimes have not had any significant say in the pay structures for CEOs.

Seventeen million is a lot for Main Street to stomach. Listen. $17 million is an extraordinary amount of money. Of course, there are some baseball players who are making more than that and don't get to the World Series either, so I am shocked by that as well.

I guess the main principle we want to promote is safe say on pay, that shareholders have a chance to actually scrutinize what CEOs are getting paid, and I think that serves as a restraint and helps align performance with pay. The other thing we do think is the more that pay comes in the form of stock that requires proven

259. POZEN, supra note 163, at 291.
261. Id. at 111.
performance over a certain period of time, as opposed to quarterly earnings, is a fairer way of measuring CEO success and, ultimately, will make the performance of American businesses better. \textsuperscript{262}

Conspicuously does President Obama \textit{not} signal—as might Chief Judge Easterbrook—that no corporate executive compensation issue arises if shareholders can always sell their stock, and thus invest elsewhere? Are corporate executive tip-top earners truly worth their keep? \textsuperscript{263}

And \textit{Jones} caught the eye of the Supreme Court partly because \textit{Jones} entailed an unusual clash between Chief Judge Easterbrook and Judge Posner. \textsuperscript{264} Those jurists number among the American judiciary’s foremost law and economics thinkers. \textsuperscript{265} Each man generally sympathizes with letting legal questions be settled through marketplace values. \textsuperscript{266} Certainly one learns that legal issues are analyzable from varied angles, many such angles enabling the harvesting of bountiful yields. \textsuperscript{267} That the subdiscipline of law and economics—roughly a subdiscipline of microeconomics’ marketplace values—thrives is demonstrable because, \textit{inter alia}, scholars of that area not merely publish academically, but as United States federal judges can influence the legal system firsthand. \textsuperscript{268} When Professor Bingyuan Hsiung of the National Taiwan University Department of Economics made this latter point, Hsiung cited as exemplars both and only Easterbrook and Posner. \textsuperscript{269} The Supreme Court granted a petition for issuance of a writ of certiorari in \textit{Jones
on March 9, 2009,\(^{270}\) to resolve a split over the proper section 36(b) standard among the Courts of Appeals.\(^{271}\)

VI. THE ORAL ARGUMENT OF NOVEMBER 2, 2009

During the November 2, 2009, oral argument over Jones in the Supreme Court, Chief Judge Easterbrook's new understanding of the limits upon those fees that investment advisers can charge mutual funds\(^{272}\) went undefended by anyone concerned.\(^{273}\) Some among the Justices suggested that a regulatory body might be better-positioned than is the judiciary to ascertain whether fees are not appropriate.\(^{274}\) Conservative Justices, shying from the Easterbrook logic, appeared skeptical of arguments that investors are in need of court intervention to defend them from the gravid fees that a fund manager might cut with a board, with which he or she enjoys a chummy relationship.\(^{275}\) Chief Justice John G. Roberts, Jr. and Justice Antonin Scalia were the most outspoken in positing that government regulators, or consumers, were the preferable monitors of these fees.\(^{276}\)

In an exchange of Chief Justice Roberts, Justice Scalia, and Justice Ruth Bader Ginsburg with Assistant to the Solicitor General Curtis E. Gannon—arguing on behalf of the United States, as amicus curiae, supporting the Jones petitioners—Roberts and Scalia referred to the Securities and Exchange Commission as if to imply Congress ought never have attached the Investment Company Act section 36(b) fiduciary duty at all:

CHIEF JUSTICE ROBERTS: Counsel, if we are going to have regulation of what fees can be charged, you cite in your brief the various regulations the SEC has issued. It makes a lot more sense to have the SEC regulate rates than to have courts do it, doesn't it?

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271. Jones v. Harris Assocs. L.P., 130 S. Ct. 1418, 1422 (2010). “The [Seventh Circuit panel] opinion [in Jones] is recognized to have created a circuit split, although the panel did not acknowledge this or circulate its opinion to the full court in advance of publication, as is required when a panel creates a circuit split.” Jones v. Harris Assocs. L.P., 537 F.3d 728, 732 (7th Cir. 2008) (Posner, J., dissenting) (per curiam).
273. Liptak, supra note 258.
274. See id.
275. Bravin, supra note 272.
276. Barnes, Investment Fees, supra note 265.
MR. GANNON: Well, in the abstract, it might make more sense, Mr. Chief Justice. I think the choice that Congress made here was to counterbalance the—

CHIEF JUSTICE ROBERTS: You are not suggesting the SEC wouldn't have authority to do that, are you?

MR. GANNON: Well, even under this statute, the SEC has the authority to file suits under section 36(b).

JUSTICE GINSBURG: Has it filed any?

MR. GANNON: It hasn't filed any since—since 1980, Justice Ginsburg. I think that the SEC in this context—it has—it has primarily directed its resources and energies into encouraging there to be better disclosure of fees, both the disclosure of information to the board, disclosure to investors, better education to shareholders so that they would be able to go—

JUSTICE SCALIA: Well, it must be aware of the—of the divergence between the fees that investment advisers charge to these companies and what they charge to other clients. Isn't the SEC aware of that?

MR. GANNON: It is aware of that.

JUSTICE SCALIA: And yet has brought no suits against this industry?

MR. GANNON: Since 1980 it hasn't used section 36(b). It has used less formal mechanisms in the context of examinations and investigators—

JUSTICE SCALIA: For disclosure, just for disclosure. But that suggests to me that the SEC may think that this is indeed a self-contained industry and that the comparison with investment advice given to other entities is—is not a fair one.277

Yet Justices Stephen G. Breyer and Sonia Sotomayor questioned whether a free market could be relied upon to police fees.278 Justice Breyer

evinced concern over the cozy relationship with the fee-setting board of directors. Justices Breyer, Sotomayor, and Ruth Bader Ginsburg appeared to support the notion that mutual fund boards ought to utilize as their benchmarks those fees that asset managers levy upon institutional investors, according to Chicago-Kent College of Law Assistant Professor William A. Birdthistle, who attended the hearing. Birdthistle had filed a brief in support of investors on behalf of over twenty law professors.

Commentators presciently supposed that the Easterbrook opinion was unlikely to survive the forthcoming Supreme Court opinion in Jones. Questioning seemed to signal that the bench was inclined to decide Jones narrowly. It was unclear whether the Justices would return Jones to the lower courts to forge a new standard, or would tackle that job themselves. Liberal Justices, including Breyer and Ginsburg, appeared disposed toward the remand of Jones for further proceedings to flesh out disputed fee arrangement facts. It remained unclear how substantial a role the Supreme Court might assign to the comparison with fees charged institutional investors.

VII. INTERLUDE: COMMISSIONER PAREDES ON JONES

A. The Securities and Exchange Commission Guards America

On May 4, 2009, Commissioner Paredes addressed Jones’ issues on his own behalf, and not that of the Securities and Exchange Commission or of his fellow Commissioners:

279. Barnes, Investment Fees, supra note 265.
282. Liptak, supra note 258.
283. Barnes, Investment Fees, supra note 265.
284. Liptak, supra note 258. “Despite a line of questioning that seemed to suggest that the Supreme Court justices are leery of getting into the business of setting standards, however, it is hard to tell what the court will ultimately determine.” David Hoffman, Advisers: SEC, Not Courts, Should Set Standards for Mutual Fund Fees, INV. NEWS, Nov. 9, 2009, at 20.
286. See Liptak, supra note 258.
Section 36(b) of the Investment Company Act, adopted in 1970, provides that the “investment adviser of a [mutual fund] shall be deemed to have a fiduciary duty with respect to the receipt of compensation . . . .” Section 36(b)’s adoption was driven by the view that the investment adviser’s fee negotiation with the fund is not at arm’s length, but tilts in the adviser’s favor, because the fund, in practice, is captured by the adviser.288

Yes, the captive mutual fund. At this juncture, Paredes added that the relevant legislative history sustained his view, quoting a Senate Report:

Since a typical fund is organized by its investment adviser which provides it with almost all management services and because its shares are bought by investors who rely on that service, a mutual fund cannot, as a practical matter sever its relationship with the adviser. Therefore, the forces of arm’s-length bargaining do not work in the mutual fund industry in the same manner as they do in other sectors of the American economy.289

This Maytime Paredes here sounded receptive to protection of consumers by the Supreme Court in Jones. Nevertheless, as oral argument in Jones loomed, the Commissioner on September 24, 2009, seemed to have changed his tune. Paredes then related—on his own behalf—of Jones:

Much could be said about the case. Indeed, the briefs are extensive. I will limit myself to highlighting two core points, leaving the details to others.

First, adequate market discipline can obviate the need for more exacting and burdensome regulation, including demanding judicial scrutiny of advisory fees. One can conceive of the section 36(b) fiduciary duty as compensating for a lack of competition in the mutual fund industry. Put differently, the legal accountability of section 36(b) can be thought of as substituting for a lack of market-based accountability. The industry, however, has changed since section 36(b) was adopted in 1970 and Gartenberg was decided in 1982. To the extent the industry has become more competitive, it may argue for greater judicial deference to the bargain the adviser and the fund strike. In the face of sufficient market


forces that constrain advisory fees, the need for courts to monitor as strictly the adviser/board fee negotiations is mitigated.

Second, courts are not well-positioned to second-guess the business decisions that boards and others in business make in good faith. Judges may exercise expert legal judgment, but not expert business judgment. A judge may be equipped to monitor a board’s decision-making process, but should steer clear of the temptation to override substantive outcomes. These sensibilities cut against reading section 36(b) as implementing a sort of substantive limit on fees and instead recommend that courts focus on the process by which the fees were determined.

An especially large advisory fee that appears to be “disproportionate” would seem to evidence that the decision-making process that produced the fee was inexcusably tainted, giving rise to a section 36(b) fiduciary duty breach. However, if on further scrutiny a court determines that careful, conscientious, and disinterested mutual fund directors agreed to the fee, little, if any, room is left for the court to declare that the fee is nonetheless so large that it could not be the result of an arm’s-length bargain. To the contrary, if a faithful, diligent board decided that the fee was appropriate, it would seem to rebut any preliminary determination that the fee ran afoul of section 36(b). The prospect that perhaps a better bargain could have been driven is a slim justification for allowing judges—who have no comparative expertise negotiating or setting advisory fees—to substitute their judgment for the collective judgment of independent directors acting in good faith. 290

Paredes’ language signaling that market discipline obviates the need for demanding judicial scrutiny, that courts are ill-positioned to second-guess boards, and board diligence would rebut pro-consumer determinations, seemed language pro-boards in Jones.

For years observers moaned, even during the Jones Supreme Court litigation, 291 that the Securities and Exchange Commission had more and more


291. See, e.g., Jim McTague, The GOP Gets Wired, BARRON’S, Jan. 25, 2010, at 48, 49 (“I don’t share his faith in the SEC. It became a captive of the industry under previous administrations. As for Chairman [Mary] Schapiro, she headed the self-regulatory arm of the Nasdaq exchange during the time that Nasdaq member Bernie Madoff pulled of the biggest Ponzi scheme since the launch of Social Security.”). On the other hand, additional voices hurrahed a supposed Securities and Exchange Commission revitalization through, for example, its reor-
waxed sympathetic to the pleading of potent corporations at cost to its protection of the public. By 2009, when Mary Shapiro assumed the captaincy of the SEC, it was a laughingstock. By 2010, something of a litany of Commission limitations, and Commission regulatory failings could be recited. A substantial cause of the mid-September 2008 financial collapse


Do you have the staff and budget to protect investors?

We clearly don’t in order to do the job I want to be done. We are 3,800 people total, and we regulate 35,000 public entities: 12,000 public companies for their disclosure, 11,300 investment advisers, 8,000 mutual funds, 5,000 broker-dealers, 600 transfer agents, exchanges, clearinghouses.

And we are smaller than we were in 2005. We got our budget increased [23%, to $1.1 billion] for fiscal 2010, and we’re working hard with Congress and the administration to increase it much more substantially in upcoming years.

Id.

294. POSNER, THE CRISIS OF CAPITALIST DEMOCRACY, supra note 151, at 41. A Commission sin of omission was its failure to break the longrunning, high-profile Bernard Madoff Ponzi scheme: “In fact, after Madoff was arrested, his secretary revealed that the few times SEC investigators had come to the firm most of them had asked for employment applications. That was typical.” HARRY MARKOPoulos, NO ONE WOULD LISTEN: A TRUE FINANCIAL THRILLER 63 (2010). “My error was in believing the SEC actually was capable of protecting investors.” Id. Madoff case- whistleblower Markopolos even shares his 2005 submission, concerning that Ponzi scheme, to the SEC. See generally id. at 297–338 (App. B).

Credible is the secretary’s report. For: “The revolving door can turn swiftly at the Securities and Exchange Commission.” Tom McGinty, Staffer One Day, Opponent the Next, WALL ST. J., Apr. 5, 2010, at C1. Sixty-six of its former employees filed 168 letters with the
was that regulators slept at the switch.\textsuperscript{295} The Securities and Exchange Commission brandished all of the statutory authority required to forestall broker-dealers from shouldering more risk than was prudent for the economy.\textsuperscript{296} But according to Judge Posner, the agency completely dropped the ball.\textsuperscript{297} After all, the Commission is the shop with the attorneys who do their own photoduplicating, filing, and mail-sorting.\textsuperscript{298} Such budgetary strategizing begets thriftily-hired lawyers but gives birth to dearly-hired clerical staff. The sole practical means of averting an overly large housing bubble—aside from hiking interest rates—would have been rigorous enforcement by, \textit{inter alia}, the Commission of its authority over shadow banks.\textsuperscript{299} Most of these


\textsuperscript{295} POSNER, \textit{THE CRISIS OF CAPITALIST DEMOCRACY}, supra note 151, at 336.

\textsuperscript{296} \textit{Id.} (citing Michael J. Halloran, \textit{Systemic Risks and the Bear Stearns Crisis}, in \textit{THE ROAD AHEAD FOR THE FED} 151 (John D. Ciorciari & John B. Taylor eds., 2009)).

\textsuperscript{297} \textit{Id.} at 173. “In the immediate wake of the financial crisis, a view held by some was that the SEC would not survive the then-nascent effort to launch financial regulatory reform.” Erich T. Schwartz, \textit{Investor Protection and SEC Enforcement New Authority and Directed Studies Increase Risks and Costs for Firms}, in \textit{THE DODD-FRANK ACT: COMMENTARY AND INSIGHTS} 143, 147 (2010).


In the United States, between 1980 and approximately 2006 had arisen an “essentially unregulated shadow banking sub-industry of financial institutions that provided a variety of banklike services,” virtually to a parity with commercial banking. \textit{POSNER, THE CRISIS OF CAPITALIST DEMOCRACY}, supra note 151, at 42. The biggest objection to separating commercial banking from shadow banking derives from delineating what is or is not commercial banking. \textit{Id.} at 360. Finance Prof. Gary B. Gorton of Yale contends:

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are SEC regulated. Yet, according to Judge Posner, the Commission lacks expertise in systemic risk matters.

In all events, such has proceeded the rise of mutual funds that Commissioner Paredes wondered whether industry evolution since the 1970 enactment of the Investment Company Act justifies an expanded judicial deference to the adviser-fund bargain. Moreover, after the November second oral argument in Jones, the Commissioner—on his own behalf—cautioned concerning comparing retail fund advisory fees against fees levied against institutional funds:

I would add that if the Court were to require a comparison of fees, judges still should not second-guess the substance of the independent directors' good faith evaluation of the fees charged different funds and the reasons justifying any fee differences. To say that the board is to consider a particular factor should not dictate how that factor is considered and how it impacts a final fee determination. Simply put, fee comparisons should not morph into fee caps.

Is a watchdog against fee caps the more defending the fund—i.e., investors—from the adviser, or the more protecting the monied adviser from its fund? Fittingly was the concept of the Securities and Exchange Commission as chief defender of mutual fund shareholders fully developed for the Supreme Court in Jones in an amicus curiae brief filed by the Mutual Fund

The events of 2007 are essentially a repeat of the 19th century bank runs, only in 2007 some firms ran on other firms. What has become known as the “shadow banking system” is, in fact, genuine banking and, it turns out, was vulnerable to the same kind of bank runs as in previous U.S. history.

GARY B. GORTON, SLAPPED BY THE INVISIBLE HAND: THE PANIC OF 2007 (2010). One major shadow bank was Bear Stearns and another was Lehman Brothers. John Cassidy, Lessons From the Collapse of Bear Stearns, Fin. Times (London), Mar. 15, 2010, at 9. If it quacks, it is a duck. If it borrows short and lends (or invests) long, it is a bank. Officially, Bear Stearns and Lehman Brothers were investment companies; Washington Mutual was a savings & loan; AIG was an insurance company, GMAC and GE Capital were subsidiaries of industrial corporations; the Reserve Fund was a money market mutual fund. In reality, all of them were handing out money, or near money, and accumulating illiquid assets. Any such institution is vulnerable to a run by creditors and regulators should treat them alike—as banks. Failure to adhere to this principle will result in regulatory arbitrage and more blow-ups.

Id. See Posner, The Crisis of Capitalist Democracy, supra note 151, at 38, 56.

Id. at 352.

See, e.g., Fink, supra note 37.

Paredes, supra note 40.

Id.
Directors Forum on behalf of Harris Associates. One recollects Assistant to the Solicitor General Gannon’s report to Justice Ginsburg that the Securities and Exchange Commission had filed no suits under section 36(b) since 1980.

B. Washington Guards America

To be sure, Washington might showcase over a half-dozen avowedly-consumer financial protection bureaus. Who else other than the Securities and Exchange Commission champions the mass of investors confronting monied opportunists? The Congressional Oversight Panel was created in 2008 to monitor the Department of the Treasury’s bank-bailout, and to review financial market regulation. Harvard Law School Professor Elizabeth Warren chairs that Panel. In a March 3, 2010 interview, Chair Warren held:

Someone said monetary policy was in the penthouse and consumer protection was in the basement.

It’s the stepchild nobody wants. There’s nobody in Washington focused on the economics of the family, focused on the consumer products—credit cards, mortgages, car loans, overdraft fees. All the stuff you have to do in your daily life to survive economically.

Chair Warren could expatiate:


306. See Transcript of Oral Argument, supra note 277, at 20–21 and accompanying text.


A whole new bureaucracy even though the Fed has the tools to start doing it tomorrow?

There are seven bureaucracies in Washington right now that each own a piece of consumer financial protection. Bloated, inefficient, and either ignored and ineffective or captured by the large financial institutions. [This is] the regulatory system we’ve got now. It works very well for the large financial institutions because it means no effective regulation.\(^{310}\)

Familiar to students of law and economics is the capture theory of the regulatory agency.\(^{311}\) Regulated firms capture their own regulators via lobbying to promote parochial, not economy-wide, business interests.\(^{312}\) The capture theory of the regulatory agency proves applicable particularly in the financial sector.\(^{313}\) Was it not relevant in Jones?

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\(^{311}\) See Swan, supra note 222, at 120–22. “In the regulatory minuet, the consumer interest and the producer interest are opposed.” Id. at 129. The relationship between the Interior Department’s Minerals Management Service and BP proved “a striking example of regulatory capture.” Gerald P. O’Driscoll, Jr., The Gulf Spill, the Financial Crisis and Government Failure, WALL ST. J., June 14, 2010, at A17.

One place we’ve already begun to take action is at the agency in charge of regulating drilling and issuing permits, known as the Minerals Management Service. Over the last decade, this agency has become emblematic of a failed philosophy that views all regulation with hostility—a philosophy that says corporations should be allowed to play by their own rules and police themselves. At this agency, industry insiders were put in charge of industry oversight. Oil companies showered regulators with gifts and favors, and were essentially allowed to conduct their own safety inspections and write their own regulations.


\(^{312}\) Heremans, supra note 220, at 951.

\(^{313}\) Id. at 952.
VIII. JUSTICE ALITO’S GARTENBERG-PLUS OPINION

A. Jones Ratifies Gartenberg

Justice Samuel Alito’s opinion in Jones\(^\text{314}\) for the Supreme Court attracted a concurrence from Justice Clarence Thomas.\(^\text{315}\) Jones met with no dissents. Justice Alito explained that the Court therein measured what mutual fund shareholders must prove to show that their mutual fund adviser has breached its fiduciary duty under section 36(b).\(^\text{316}\) The Court, as mentioned in Section V C, supra, had granted certiorari\(^\text{317}\) to resolve a division among the Courts of Appeals over that appropriate section 36(b) standard.\(^\text{318}\)

In Section I of Jones, Justice Alito acknowledged that a typical arrangement is that a mutual fund, which might have no employees of its own, is created by a separate entity denominated as an investment adviser.\(^\text{319}\) This adviser not only manages the fund investments and delivers other services, but also selects the fund’s directors.\(^\text{320}\) Due to this intimate investment adviser-mutual fund symbiosis, a fund oftentimes practically cannot sever the relationship.\(^\text{321}\) This walls-off the normal forces of arm’s-length bargaining.\(^\text{322}\) Here, Alito echoes the Commissioner Parades of May 24, 2009. Because of Congressional concern over the potential for abuse consequently inhering in the investment companies’ structure, the Investment Company Act of 1940\(^\text{323}\) was adopted.\(^\text{324}\) In a further response to difficulties relative to investment company board independence, and to investment adviser compensation, Congress amended that Act in 1970.\(^\text{325}\) Thereby was reinforced the independence of the mutual fund board of directors, which scrutinizes and negotiates the adviser’s compensation.\(^\text{326}\) Also, section 36(b) then imposed both the fiduciary duty upon the investment adviser respecting its income from the “mutual fund, and granted [the] individual investor[] [the]
private right of action for breach of [such] duty." Once more, Alito channels the May 24 Parades. The fiduciary duty did not, however, permit a court review for the reasonableness of the compensation agreement.

Justice Alito related that the Jones petitioners were "shareholders in three different mutual funds managed by respondent Harris Associates L.P., the investment adviser." Petitioners had sought damages, an injunction, and the rescission of advisory agreements between their funds and Harris Associates. Their complaint had alleged the violation of section 36(b) in Harris Associates' charging of fees "disproportionate to the services rendered" and beyond the ambit of what would have been reached via arm's-length negotiations "in light of all of the surrounding circumstances." The District Court had granted summary judgment for Harris Associates by applying the Gartenberg standard. "The District Court assumed that it was relevant to compare the challenged fees with those that Harris Associates charged its other clients." Justice Alito recalled that the Seventh Circuit panel in Jones had affirmed, but had based its affirmance upon its own Easterbrook reasoning, disavowing Gartenberg. That panel's reasoning, as indicated in Section IV, supra, focused nearly wholly upon the disclosure element. Yet Alito's opinion likewise recalled that upon that Circuit's denial of rehearing en banc, Judge Posner dissented that this rejection of Gartenberg was premised on "economic analysis . . . ripe for reexamination."

In Section II of Jones, Justice Alito's Jones discussion of Gartenberg was somewhat detailed:

[W]e conclude that Gartenberg was correct in its basic formulation of what § 36(b) requires: to face liability under § 36(b), an investment adviser must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services ren-

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328. Jones, 130 S. Ct. at 1423.
329. Id. at 1424.
330. Id.
331. Id.
332. Id.
333. Jones, 130 S. Ct. at 1424.
334. Id.
335. Id.
336. Id. (quoting Jones v. Harris Assocs. L.P., 537 F.3d 728, 730 (7th Cir. 2008) (Posner, J., dissenting) (per curiam)).
337. Id. at 1425–28.
dered and could not have been the product of arm's length bargain-
ing.338

Correct in its basic formulation. The Gartenberg approach adheres to the correct comprehension of fiduciary duty and the section 36(b)(1) imposition of the burden on the plaintiff.339 Approval of the adviser's fee by the board of directors is to be awarded as much consideration by the judiciary as appropriate given all of the circumstances; and the benchmark for reviewing challenged fees is the range possibly emergent from an arm's-length bargain.340 The Gartenberg approach also adheres to the requisite role of the fully-informed mutual fund board encompassing its statutorily-prescribed disinterested directors:341 "First, a measure of deference to a board's judgment may be appropriate in some instances. Second, the appropriate measure of deference varies depending on the circumstances."342

Gartenberg, being thus established as correct in its basic formulation, what adds Jones to this Gartenberg foundation, sculpting Jones into a Gartenberg-plus?

B. The Jones Additions to Equal a Gartenberg-Plus

In Section III—the main event of Jones—Justice Alito, without dissent, adds these Supreme Court teachings: "The first concerns comparisons between the fees that an adviser charges a captive mutual fund and the fees that it charges its independent clients."343 Gartenberg, as related in Section IV, supra, rejected the comparison of fees the adviser in Gartenberg had charged a money market fund (captive mutual fund) and those it had charged a pension fund (independent client).344 Alito contrariwise determined that, inasmuch as the statute mandates considering every relevant factor:345 "[W]e do not think there can be any categorical rule regarding the comparisons of

341. Id.
342. Id. at 1428.
343. Id.
344. Id. at 1429-30.
345. Jones, 130 S. Ct. at 1428.
the fees charged different types of clients.” His explicit preclusion of any categorical rule marks an Alito addition to Gartenberg:

Instead, 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, but courts must be wary of inapt comparisons. As the panel below noted, there may be significant differences between the services provided by an investment adviser to a mutual fund and those it provides to a pension fund which are attributable to the greater frequency of shareholder redemptions in a mutual fund, the higher turnover of mutual fund assets, the more burdensome regulatory and legal obligations, and higher marketing costs. . . . If the services rendered are sufficiently different that a comparison is not probative, then courts must reject such a comparison. Even if the services provided and fees charged to an independent fund are relevant, courts should be mindful that the Act does not necessarily ensure fee parity between mutual funds and institutional clients contrary to petitioners’ contentions.

This explicit preclusion of any categorical rule respecting comparing fees charged to different types of clients developed the law in a pro-plaintiff direction—fee parity between mutual funds and institutional clients being not necessarily guaranteed by the Act.

The Alito opinion continues: “By the same token, courts should not rely too heavily on comparisons with fees charged to mutual funds by other advisers. These comparisons are problematic because these fees, like those challenged, may not be the product of negotiations conducted at arm’s length.”

346. Id. According to one emphatic report: “Next, however, unlike the 2nd Circuit in Gartenberg, the Supreme Court asserted that ‘comparisons between the fees that an adviser charges a captive mutual fund and the fees that it charges its independent clients’ are relevant.” Jennifer S. Taub, Jones v. Harris Associates: Let the First Lawsuit Bloom, RACE TO THE BOTTOM (Mar. 30, 2010, 10:36 AM), http://www.theracetothebottom.org/miscellaneous/jones-v-harris-associates-let-the-first-lawsuit-bloom.html (emphasis in original).

347. Jones, 130 S. Ct. at 1428–29 (citation omitted).

348. Id. at 1429. Likewise had reasoned Circuit Judge Mansfield for the Second Circuit panel. Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 694 F.2d 923, 925 (2d Cir. 1982). Appallingly, comparison of an investment adviser’s fee against fees charged to mutual funds by other advisers are problematic on additional grounds:

Remarkably, most boards allow the fund company to define the peer group. In the Oakmark case, for example, Oakmark Fund’s fees were compared with those of just nine other funds. By my count, there are [fifty-one] no-load, actively managed, large-blend funds with more than $1 billion in assets. So what happened to the other [forty-one] funds that didn’t make the peer analysis?
Carefully apprehend precisely why courts should not rely too heavily upon comparisons against fees charged mutual funds by other advisers. The problem is that those fees, themselves, might not be the outcome of arm’s-length negotiation. Expressly, the Supreme Court grasps that the feared problem is that such comparison-fees are therefore excessive, and so would be comparative evidence too pro-defendant-adviser.

Justice Alito instructs: “Finally, a court’s evaluation of an investment adviser’s fiduciary duty must take into account both procedure and substance.”\textsuperscript{349} Understand:

Thus, if the disinterested 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. . . . This is not to deny that a fee may be excessive even if it was negotiated by a board in possession of all relevant information, but such a determination must be based on evidence that the fee “is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm’s-length bargaining.”

In contrast, where the board’s process was deficient or the adviser withheld important information, the court must take a more rigorous look at the outcome.\textsuperscript{350}

The board of directors’ procedures, which Alito here exacts, demand that the board endorsing a particular fee arrangement not merely have possessed “all relevant information,” but actually have “considered the relevant factors” behind a fee approval for said approval to merit a “considerable weight.”\textsuperscript{351} As for substance, explicitly, “a fee may be excessive even if it was negotiated by a board in possession of all relevant information.”\textsuperscript{352} And remember that Jones already declares that since the statute requires board consideration of all relevant factors even the courts applying the statute, to say nothing of boards, can balance an adviser’s captive fund fees against its

\begin{itemize}
  \item Kinnel, \textit{supra} note 129, at 49. In its evaluation of charges, a board of directors starts with the 15(c) report, measuring its own fund’s fees against those charged to competitors. \textit{Id.} Investment Company Act of 1940, 15 U.S.C. § 15(c) (mandating such reports) is further discussed in the text in Section XA, \textit{infra}. Whom do captive mutual fund boards of directors really serve? “No man can serve two masters: for either he will hate the one, and love the other; or else he will hold to the one, and despise the other.” \textit{Matthew} 6:24; \textit{Luke} 16:13 (King James).
  \item Jones, 130 S. Ct. at 1429.
  \item \textit{Id.} at 1429–30 (quoting Gartenberg, 694 F.2d at 928).
  \item \textit{Id.} at 1429.
  \item \textit{Id.}
\end{itemize}
independent client fees. Hence, should the board’s process—assessing the relevant factors—prove deficient, the judge can move the more rigorously in testing the challenged fee.

It is at this juncture that Justice Alito reminds: “It is also important to note that the standard for fiduciary breach under [section] 36(b) does not call for judicial second-guessing of informed board decisions.” A trifling shortcoming of this Jones opinion emergent from Justice Alito’s pen, or at least from his chambers, lies in its treatment here, of its Daily Income Fund, Inc. v. Fox precedent. Prior to the 1970 statutory amendments, the Securities and Exchange Commission proposed that Congress empower the agency to launch actions challenging an unreasonable fee, and to intervene in similar actions brought by, or on the behalf of, an investment company. Justice Alito accurately recounts how industry representatives successfully resisted such proposal, for fear it “‘might in essence provide the Commission with ratemaking authority.’” The Commission. Yet the Alito opinion later erroneously cites Daily Income Fund for the proposition that Congress repudiated a reasonableness requirement under fire for “charging the courts with rate-setting responsibilities,” as distinguished from thus charging the Commission.

Such a slip might be anyone’s in more than a single sense. In the twenty-first century, a Supreme Court Justice who chooses competent clerks, or merely chooses for herself a capable selector of her judicial clerks, can churn out impressive opinions absent her personal efforts. Today, the service of

353. Id. at 1430. In a sermon unearthed a few months back, Saint Augustine confessed: “‘We who preach and write books . . . write while we make progress. We learn something new every day. We dictate at the same time as we explore. We speak as we are still knocking for understanding,’” Lucy Beckett, The Question of What You Love, TIMES LITERARY SUPPLEMENT (London), Apr. 2, 2010, at 7 (quoting HENRY CHADWICK, AUGUSTINE OF HIPPO: A LIFE xv (2009)). Do jurists write opinions to second-guess others, while those daily-learning jurists themselves still explore for their own understanding?

357. Id. at 1430. Innocently does Alito alchemize “Commission” into “courts.” Notoriously did Justice Harlan Stone demote rights “delegated” to rights “surrendered:” “‘The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.’ The amendment states but a truism that all is retained which has not been surrendered.” United States v. Darby, 312 U.S. 100, 123–24 (1941) (quoting U.S. CONST. amend. X).
law clerks in opinion drafting is openly discussed. 359 The tendency has been increasingly to delegate opinion-drafting responsibilities to the clerks. 360 The jurist herself transmutes from the drafter into an editor. 361 In the Supreme Court, this evolution is all but completed—at least as is determinable from the length and from the scholarly apparatus of its Justices’ opinions. 362 Of course, to the extent that Alito’s slip evidences a misdirected judicial modesty in erroneously supposing that the 1970 Congress chose then to constrict the leeway—"second guessing" of "the courts"—consequent interpretive counterbalancing of that misguided judicial modesty facilitates readings of Jones the yet more expansively pro-judicial authority under the 1970 enactment.

In all events, not to be second-guessed board decisions look to be those "informed" by not merely a knowledge of, but by the assessment of—"[if] disinterested directors consider all of the relevant factors" 363—the captive fund fee/independent client fee comparison. A "court must take a more rigorous look at the outcome" 364 should a board-blessed fee appear born of a board not "informed," or even just behaving as if uninformed "‘bears no reasonable relationship to the services rendered’. 365 The judgment of the Court of Appeals was vacated. 366 Jones was remanded. 367

C. The Law and Economics of the Thomas Concurrence

According to Vanderbilt political scientist Pamela C. Corley, the expert on concurrences in the Supreme Court, only some concurrences in the Supreme Court support the majority’s opinion. 368 A concurrence can detract from the majority opinion’s impact by disagreeing with its reasoning. Yet it

360. Id.
361. See id. at 141.
364. Id. at 1430.
365. Id. at 1429 (quoting Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 694 F.2d 923, 928 (2d Cir. 1982)).
366. Id.
also can clarify the outcome of a case and strengthen it.\textsuperscript{369} The latter it is with Justice Clarence Thomas' concurrence in \textit{Jones}. For Justice Thomas briefly concurred to explain that he understood that the Alito opinion does not countenance the free-floating judicial fairness review of fees which Thomas feared \textit{Gartenberg} could be read to authorize.\textsuperscript{370} Thus is the judiciary instructed by Thomas—in so many words—that the \textit{Jones} enrichment of \textit{Gartenberg} is not to be confused with the banned free-ranging judicial review of the fairness of fees.\textsuperscript{371} The stance against expanding the fiduciary jurisdiction, into deciding what is fair, is apparent. Flannigan stated, "Attempting to determine whether decisions are fair or reasonable is very different from attempting to ensure that they are made in good faith without the distortion of self-regard."\textsuperscript{372}

Sure enough, Flannigan, the law and economics expert, like Justice Thomas cautions against a judicial prescriptive construction of fiduciary obligations\textsuperscript{373} (positive performance) instead of a proscriptive construction (of personal abnegation): "Loyalty in the conventional fiduciary sense is the specific obligation to eschew unauthorized conflicts or benefits."\textsuperscript{374} The former (conflicts) are permitted and, in the captive mutual fund circumstances, virtually prescribed under section 36(b). But, the latter (unauthorized benefits) are proscribed. Hence, the \textit{Jones} controversy: In such a case is an investment adviser’s conflict of interest perhaps inevitable, but an adviser-abnegation is statutorily incumbent. Flannigan, like Justice Thomas, disclaims a judicial free-ranging fairness review in favor of judges, instead, ensuring that a fiduciary’s actions are taken sans any distorting self-regard.\textsuperscript{375} \textit{Jones}, of course, actually exemplified the charge of a fiduciary investment adviser’s fee-taking having been distorted by its self-interest. Flannigan articulates the implicit premises impelling Thomas’ seal of approval on Alito’s \textit{Gartenberg}-plus opinion.

\textbf{IX. THE FINANCIAL PRESS GREET S \textit{GARTENBERG}-PLUS}

The \textit{Jones} ruling was hailed alike by fund industry representatives and by investors’ advocates. Sure enough, one report on the morning of \textit{Jones}
was headed: *Jones v. Harris Associates: Let the First Lawsuit Bloom.*\(^{376}\) The *Wall Street Journal* at once emphasized that the Supreme Court had granted “leeway” for fund fee lawsuits.\(^{377}\) Shortly thereafter, it quoted Professor Birdthistle: “‘This isn’t just *Gartenberg*, this is *Gartenberg*-plus . . . . The [C]ourt has reconstructed *Gartenberg* to emphasize the discrepancy between retail [individual-investor-oriented] and institutional fees.’”\(^{378}\) Heading its story *Lower Fees, Courtesy of Supreme Court,*\(^{379}\) the *Journal* submitted: “The new, *Gartenberg*-plus standard may require firms to inform fund boards how much they charge other clients and explain the difference in fees—something critics claim will be hard to do.”\(^{380}\) Indeed, *Jones* “added a wrinkle that will put more pressure on fund companies to justify charging individual investors more than big institutional clients,”\(^{381}\) Rob Silverblatt reported that in Alito’s opinion “there’s a bit of a twist.”\(^{382}\) *Jones* delivers “some wiggle room to investors who claim that certain fee differentials are abusive.”\(^{383}\)

*Wrinkle. Twist. Pressure. Investment News* headed its page-one news story *High Court Ruling Opens Door for More Lawsuits Over Mutual Fund Fees.*\(^{384}\) It opened:

While the Supreme Court’s ruling last week on a controversial lawsuit over mutual fund fees was viewed as a huge win by the mutual fund industry, the decision will likely put more pressure on the boards and managements of fund companies to defend their fees and could open the door to even more litigation.\(^{385}\)

*Pressure. Hard to do.* And *Investment News* editorialized: “*Jones v. Harris,* though a loss for the plaintiffs, might well result in a long-term win for all mutual fund shareholders, if, as seems likely, it leads fund directors to

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379. *Id.*
380. *Id.*
381. *Id.*
383. *Id.*
385. *Id.*
exercise their independence more fully, and this leads to better fund governance and perhaps lower fees.\textsuperscript{386} Lower fees.

According to Gregory Ash, chairman of the Employee Retirement Income Security Act litigation group at Spencer Fane Britt & Browne LLP:

Now, when these cases are filed, courts are going to have to do a lot more digging to see if the board of directors and fund management fulfilled their fiduciary duties . . . . If a plaintiff is able to draft a complaint carefully enough to follow what is essentially a blueprint laid out in this opinion on how to establish a [legally viable] claim, they will at least get to summary judgment.\textsuperscript{387}

Offers Barry Barbash, a partner in Willkie Farr & Gallagher LLP and former director of the Securities and Exchange Commission Division of Investment Management: “Fund companies are going to need to be a lot more analytical with looking at their accounts and fees. . . . A data dump isn’t going to work.”\textsuperscript{388} Bear in mind the wisdom of Nobel Laureate Simon: A data dump conceals, not reveals, an investment adviser’s dirty laundry.

Morningstar’s Russel Kinnel perceived that the Jones understanding of critical facets of Gartenberg might hand shareholders a tad more power: “The [C]ourt also said that boards should examine whether the fees paid are comparable to those paid by other clients when the services and investment strategy are comparable.”\textsuperscript{389} On the other hand, the independent chair of Investco Ltd.’s mutual fund line, Bruce Crockett, asserted that the contention that Jones would change the industry presumes that fund boards have not been looking at different fees, but they have: “I don’t see how this changes much . . . . Plaintiff’s bar will continue to try and find areas to test and fees will be one of them.”\textsuperscript{390}

After the Supreme Court granted certiorari in Jones to resolve a split among the Courts of Appeals concerning what a mutual fund shareholder must prove to demonstrate that a mutual fund investment adviser had

\begin{itemize}
  \item \textsuperscript{386} Editorial, \textit{Ruling May Benefit Fund Shareholders in the Long Run}, \textit{INV. NEWS}, Apr. 12, 2010, at 8.
  \item \textsuperscript{387} Marquez, \textit{supra} note 384. “‘With this ruling, a higher standard of conduct has been placed on mutual fund investment advisers, who help millions of people manage their retirement income.’ says Jay Sushelsky, attorney for AARP.” John Waggoner, \textit{Mutual Fund Fees Case Goes Back to Lower Court}, \textit{USA TODAY}, Mar. 31, 2010, at B1.
  \item \textsuperscript{389} Kinnel, \textit{supra} note 129, at 49.
  \item \textsuperscript{390} Mamudi, \textit{supra} note 378.
\end{itemize}
breached its fiduciary duty as to compensation for services, the United States Court of Appeals for the Eighth Circuit adopted the Gartenberg standard in *Gallus v. Ameriprise Financial, Inc.*\(^{391}\) On April 5, 2010, the Supreme Court granted certiorari in *Gallus*, remanding *Gallus* to the Eighth Circuit for further consideration in view of *Jones*.\(^{392}\) As Professor Birdthistle interpreted this remand, “It’s still difficult to be a plaintiff, but it’s easier today that [sic] it was seven days ago.”\(^{393}\) Then, General Counsel Karrie McMillan of the Investment Company Institute, a mutual fund industry trade group, opined, “I don’t think the Supreme Court . . . really changed the way the boards do things as a practical matter.”\(^{394}\) On the other hand, the *Wall Street Journal* reporting on *Gallus* subheaded its news story: *Decisions May Be Making Suits Easier*.\(^{395}\)

What gap was filled by Justice Alito’s *Gartenberg*-plus opinion in *Jones*?

X. **WHY THE CRY FOR A *GARTENBERG*-PLUS OPINION?**

A. **The Substance of Things Hoped For**

The Investment Company Act of 1940 provides in relevant part in section 15(a):

> *It shall be unlawful for any person to serve or act as investment adviser of a registered investment company, except pursuant to a written contract, which contract, whether with such registered company or with an investment adviser of such registered company, has been approved by the vote of a majority of the outstanding voting securities of such registered company, and—*

\(^{391}\) 561 F.3d. 816, 817–18, 822 (8th Cir. 2009), vacated by 130 S. Ct. 2340 (2010).

\(^{392}\) *Ameriprise Fin., Inc. v. Gallus*, 130 S. Ct. 2340 (2010). "In a case that American Funds won in a lower court and that is now on appeal, evidence showed that for at least two years American refused to tell directors about portfolio managers’ incentives.” Kinnel, *supra* note 129, at 49.

\(^{393}\) *Daisy Maxey, High Court Rules Again on Fund Fees*, WALL ST. J., Apr. 6, 2010, at C11.

\(^{394}\) *Id.*

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(1) precisely describes all compensation to be paid thereunder;

(2) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company; . . .

That Act further provides, in relevant part, in section 15(c), that:

[I]t shall be unlawful for any registered investment company having a board of directors to enter into, renew, or perform any contract or agreement, written or oral, whereby a person undertakes regularly to serve or act as investment adviser of or principal underwriter for such company, unless the terms of such contract or agreement and any renewal thereof have been approved by the vote of a majority of directors, who are not parties to such contract or agreement or interested persons of any such party, cast in person at a meeting called for the purpose of voting on such approval. It shall be the duty of the directors of a registered investment company to request and evaluate, and the duty of an investment adviser to such company to furnish, such information as may reasonably be necessary to evaluate the terms of any contract whereby a person undertakes regularly to serve or act as investment adviser of such company.396

The Securities and Exchange Commission has prepared Form N-1A, Registration Statement Under the Securities Act of 1933/Registration Statement under the Investment Act of 1940.397 Generally, Form N-1A is for the use of open-end management companies to register under the Investment Company Act of 1940 and to offer shares under the Securities Act of 1933.398 The S.E.C. designed it to afford investors information, aiding them to decide concerning investing in such an investment company.399 The Registrant is mandated to reveal the Form N-1A information, which the SEC makes public.400 The Commission also may exploit this information “in its regulatory, disclosure review, inspection, and policy making [functions].”401

398. See generally id.
399. Id. at 1.
400. Id. at 2.
401. Id. at 1.
Item 27 of Form N-1A is found in Part B thereof: “INFORMATION REQUIRED IN A STATEMENT OF ADDITIONAL INFORMATION”402 i.e., information additional to that required in a prospectus. The Form N-1A Item 27 language addressed herein was prepared as a mandatory language in 2004.403 The SEC was then conscious of specific factors invoked in the Gartenberg Second Circuit opinion toward determining whether an investment adviser meets section 36(b) fiduciary obligations, including “the adviser-manager’s cost in providing the service, the nature and quality of the service, the extent to which the adviser-manager realizes economies of scale as the fund grows larger, and the volume of orders which must be processed by the manager.”404 In the Gartenberg shareholder derivative challenge to fees paid a fund adviser, the District Court declared of the unsuccessful challengers of their fund and its adviser: “Plaintiffs offer as an apt comparison for the compensation payable by the Fund, the compensation (unspecified) that pension fund managers are paid which plaintiffs say is only a fraction of the compensation which the Fund pays.”405 So, given the 1940 Act’s section 15(c) duty of directors to solicit such data as is reasonably necessary to evaluate their investment adviser’s contract, and given that the ill-starred Gartenberg plaintiffs had been unarmed with data comparing their adviser’s fee against fees rendered pension fund managers, what disclosures demand the Commission’s Form N-1A?

Item 27(d)(6)(i) provides:

If the board of directors approved any investment advisory contract during the Fund’s most recent fiscal half-year, discuss in reasonable detail the material factors and the conclusions with respect thereto that formed the basis for the board’s approval. Include the following in the discussion:

(i) Factors relating to both the board’s selection of the investment adviser and approval of the advisory fee and any other amounts to be paid by the Fund under the contract. This would include, but not be limited to, a discussion of the nature, extent, and quality of the services to be provided by the investment adviser; the invest-

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402. SEC, FORM N-1A, supra note 397, at Part B.
403. See id. at Item 27.
ment performance of the Fund and the investment adviser; the costs of the services to be provided and profits to be realized by the investment adviser and its affiliates from the relationship with the Fund; the extent to which economies of scale would be realized as the Fund grows; and whether fee levels reflect these economies of scale for the benefit of Fund investors. Also indicate in the discussion whether the board relied upon comparisons of the services to be rendered and the amounts to be paid under the contract with those under other investment advisory contracts, such as contracts of the same and other investment advisers with other registered investment companies or other types of clients (e.g., pension funds and other institutional investors). If the board relied upon such comparisons, describe the comparisons that were relied on and how they assisted the board in concluding that the contract should be approved.

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Such revelations of factors forming the basis for board endorsement of an investment advisory contract are the things hoped for.

B. The Substance of Things Not Seen

Dissenting from the denial of rehearing en banc in Jones, Judge Posner cited scholarship indicating that the foremost reason for aggravated differences in advisory fee-levels between equity mutual fund portfolio managers, and equity pension fund portfolio managers, is that it is in the latter field that the advisory fees are subject to marketplace arm’s-length bargaining.407 Reassuringly then does Item 27(d)(6)(i) appear, at first glance, geared to post fund shareholders of how their fund’s advisory contract fee measures against fees paid to the same investment adviser by pension funds or by other institutional advisers: “indicate [in the discussion] whether the board relied upon comparisons.”408 At first blush, Item 27(d)(6)(i) seems engineered to notify fund shareholders of how their fund’s board assessed such comparisons “describe . . . how they assisted the board.”409 Indeed, the Supplementary In-

406. SEC, FORM N-1A, supra note 397, at Item 27(d)(6)(i) (emphasis added).
formation with the 2004 Release of the amendatory Final Rule recorded of this comparison of fees and services provided by the adviser.\textsuperscript{410}

Several commenters supported the proposed requirement, arguing that any responsible board would at least seek to compare the terms of the contract under consideration with relevant terms for similar funds, and that by encouraging boards to compare the compensation funds pay to their advisers with the compensation that other institutional investors pay, there may be a downward pressure on fund advisory fees.\textsuperscript{411}

Why then all the shouting in Jones? Remember Investco's Crockett, who declined to shout, "I don't see how this changes much."\textsuperscript{412}

The Jones fluster arose because real-world boards are not so adequately responsible as to compare the terms of their own adviser's contract with the compensation other institutional investors render to that same adviser. These boards do not so post investors, regarding these matters, in Form N-1A, which ostensibly is Commission-designed to provide investors data toward deciding about investing. Therefore, there is no resultant downward pressure on fund advisory fees. And boards get away with this. How? The cheery, superficial hints of disclosure by Item 27(d)(6)(i) are belied by the artful double-negative language of the Commission in its Supplementary Information.

Item 27(d)(6)(i) does not require the enumeration of those comparisons a board did not use.

Shareholders outside the legal or the financial industry, cognoscenti-perusers of the Federal Register, are not alerted to data not employed to those shareholders' benefit by their boards: "Little of what the management com-

\textsuperscript{410} Disclosure Regarding Approval of Investment Advisory Contracts by Directors of Investment Companies, 69 Fed. Reg. at 39,801.
\textsuperscript{411} Id. at 39,802.
\textsuperscript{412} Mamudi, supra note 378.
\textsuperscript{413} Disclosure Regarding Approval of Investment Advisory Contracts by Directors of Investment Companies, 69 Fed. Reg. at 39,802.
pany tells a fund’s board or how the board determines fees is in the public record until a lawsuit is filed. Consequently, investors have to sue first to find out whether they have a case.\footnote{414} The retail investors in mutual funds are not rallied to squeeze fund advisory fees south.

Certain data—assisting investment decision making—which innocent investors might expect the Securities and Exchange Commission to publish in Form N-1A exemplify, as St. Paul might preach, things hoped for. True, some funds such as index funds are comparatively cheaply managed, whereas others such as international funds are comparatively costly due to unique hassles or demands for special expertise.\footnote{415} Nevertheless, the respective investment advisory fees for mutual funds and for corporate accounts with identical investments ought to prove identical—whatever the nature of those potentially diverse underlying investments.\footnote{416} This is because investment advisory fees are distinct from those other mutual fund “expenses” properly charged to the fund shareholders.\footnote{417} But a cynical Commission blesses Form N-1A statements wherein the enumeration of comparisons a board did not use remain Paul’s things not seen. Remember Assistant to the Solicitor General Gannon’s pronouncement to Justice Ginsberg that the post-1980 SEC “has primarily directed its resources and energies into encouraging there to be better disclosure of fees, both the disclosure of information to the board, disclosure to investors, better education to shareholders.”\footnote{418} Well, did it? Fiduciary: from the Latin, fiducia, for trust.\footnote{419} “Trust can be misplaced.”\footnote{420} Qui's custodiet ipsos custodes?\footnote{421}

\footnote{414. Kinnel, supra note 129, at 49.}
\footnote{415. Paul S. Atkins, Tort Lawyers Target Mutual Funds, WALL ST. J., Nov. 2, 2009, at A19.}
\footnote{417. Id.}
\footnote{418. Transcript of Oral Argument, supra note 277, at 21. The escalating domination over productive activities in an economy by financial services is dubbed financialization. Nina Bandelj & Elizabeth Sowers, Economy and State: A Sociological Perspective 78 (2010). Financial services have skyrocketed to prominence within the American economy. Id. at 79. And economists concur that the defense of rights in private property is a government’s duty. Id. at 53. For a free market, unvexed by governmental impediment, ranks among the most familiar of economic tropes. Id. at 1. Nevertheless, a major device whereby governments do regulate firms is that of consumer protection. Id. at 130. Given this, understandably might America’s consumers trust Congress and its Securities and Exchange Commission to insulate private-property owning investors from the avarice of mutual fund investment-advisers? Well, do they?}
\footnote{419. Webster’s Third New International Dictionary 845 (2002).}
\footnote{421. Who shall guard the guards themselves? Juvenal, The Satires of Juvenal 247 (London, MacMillian & Co. 1897). The SEC touts a new brain trust focusing on, inter alia,
XI. THE LAW AND ECONOMICS OF JONES

A. Flannigan on Fiduciary Duty

Generally, “[E]conomic analysis . . . holds little utility for the lex lata” as understood strictly.422 It reveals little of how to interpret the law.423 Yet in some areas economic analysis might be a portion of the lex lata because legal rules can be understood to refer to economic concepts.424 The economic literature concerning agency has swelled phenomenally since the early 1970s.425 And economists assess opportunism in its every single incarnation.426 The analysis of opportunism by economists is associated, in the legal community, with principal/agent commentary.427 Still, very few economists have dared the economic analysis of fiduciary obligation. Their profession’s accomplishments are yet to shed much fresh light upon fiduciary accountability. Economists prodigally have lavished research on economic mechanisms to control opportunism, yet been skittish in evaluating the primary legal device.428 Also, there remains no consequential empirical data measuring whether, as to fiduciary accountability, the conventional loyalty duty is efficient.
1. Production Opportunism

Surely is the loyalty duty, fiduciary accountability, not in opposition to economic principles.\textsuperscript{429} It transpires that the economic perspective only replicates ancient principle.\textsuperscript{430} Context determining whether opportunism equals fiduciary breach,\textsuperscript{431} Flannigan explains that the context of production is applied “in its widest sense of shaping human or physical capital for any end.”\textsuperscript{432} It encompasses production of exchange just as some firms exist to broker exchanges.\textsuperscript{433} Actors undertaking to serve others acquire access to assets and opportunities connected with their service.\textsuperscript{434} They can abuse such access to advance self-interest.\textsuperscript{435} Mischief is controlled by fiduciary accountability.\textsuperscript{436}

2. Exchange Opportunism

Contrast this production opportunism against exchange opportunism.\textsuperscript{437} This opportunism occurs between production units at the exchange interface.\textsuperscript{438} Actors originally agreeing to launch production processes negotiate the terms of their contributions.\textsuperscript{439} For example, a captive mutual fund is developed by an investment adviser. These firms can permit party actions affecting renegotiation—i.e., the renewal of the investment adviser’s contract by the captive mutual fund’s board of directors. Then may one side be armed to extract concessions from the other.\textsuperscript{441} Hypothetically, an investment adviser bleeds its captive mutual fund. For exchange opportunism arises when actors bargain over their future relationship.\textsuperscript{442} Opportunistic contracting in the exchange context is generally nonactionable.\textsuperscript{443} This permissible exchange opportunism is expectable, essentially being competitive be-

\textsuperscript{429.} Id. at 428.  
\textsuperscript{430.} Id. at 393.  
\textsuperscript{431.} Flannigan, The Economics of Fiduciary Accountability, supra note 58, at 394.  
\textsuperscript{432.} Id. at 395 n.5.  
\textsuperscript{433.} Id.  
\textsuperscript{434.} Id. at 394.  
\textsuperscript{435.} Id.  
\textsuperscript{436.} Flannigan, The Economics of Fiduciary Accountability, supra note 58, at 394.  
\textsuperscript{437.} Id. at 395.  
\textsuperscript{438.} Id.  
\textsuperscript{439.} Id.  
\textsuperscript{440.} Id.  
\textsuperscript{441.} Flannigan, The Economics of Fiduciary Accountability, supra note 58, at 395.  
\textsuperscript{442.} Id. at 396.  
\textsuperscript{443.} Id.
behavior at the negotiation stage.\textsuperscript{444} This might sound heartening for an investment adviser like Harris Associates L.P.

Why is this exchange opportunism negotiation to be permitted competitive behavior? Flannigan stated, "As such, it is acceptable for all [of] the reasons that competition is generally acceptable in market economies."\textsuperscript{445} So in turn, why is competition generally acceptable in market economies? Competition guarantees alternatives. Those alternatives curb the gross misallocation of resources by competitive market firms.\textsuperscript{446} Sure enough, Justice Alito in \textit{Jones} discerned that section 36(b) obtains in light of long term Congressional worry over investment board independence and investment adviser recompense.\textsuperscript{447} The competitive market’s alternatives being \textit{suppressed} in the captive mutual fund context, the preclusion of fiduciary duty—a preclusion typical of exchange opportunism—proves inapropos. Instead, the attachment of fiduciary duty regarding compensation logically emerges. Sure enough, Congress in 1970 deputized the individual investor to enforce the investment adviser’s fiduciary duty as in \textit{Jones}.\textsuperscript{448}

3. Consent

Flannigan further explains that opportunism does not equate with actionable breach of fiduciary duty if there obtains consent.\textsuperscript{449} For instance, parties might consent to the existence of a conflict of interest, although never to actual self-dealing.\textsuperscript{450} Compare the situation wherein a manager’s firm might accept an opportunism discount reflective of the risk of opportunism—so corresponding to the firm’s heavier costs of monitoring the shifty manager—but never accept his actual opportunism. This means the parties are allowed to act notwithstanding the managerial conflict of interest, but \textit{cannot} allow the conflict to impinge upon managerial decisions. For example, directors oftentimes are allowed to name their own pay rates.\textsuperscript{451} Compare the sway of the investment adviser hypothetically dominating its captive mutual fund board as to compensation. The upshot will be actionable as a fiduciary breach if it be proved that the conflicting party \textit{did} succumb to impermissible self-regard.\textsuperscript{452}

\begin{itemize}
\item \textsuperscript{444} \textit{Id.}
\item \textsuperscript{445} \textit{Id.}
\item \textsuperscript{446} Hsiung, \textit{supra} note 205, at 15.
\item \textsuperscript{447} \textit{Jones v. Harris Assocs., L.P.}, 130 S. Ct. 1418, 1423 (2010).
\item \textsuperscript{448} \textit{See id.}
\item \textsuperscript{449} Flannigan, \textit{The Economics of Fiduciary Accountability, supra} note 58, at 399.
\item \textsuperscript{450} \textit{Id.} at 399–400.
\item \textsuperscript{451} \textit{Id.} at 400.
\item \textsuperscript{452} \textit{Id.}
\end{itemize}
Consider the post-Jones liability of an investment adviser charging a fee so outsized as to bear no reasonable relation to services rendered. Flannigan noted, "Because the existence of [a] conflict is permitted, the burden on the beneficiary changes from proving the conflict to proving actual self-interested conduct." Sure enough, it is ordained in section 35(b)(1) that the plaintiff carries the burden of proving investment adviser breach of fiduciary duty.

4. Limited Access Arrangements

Again, how is the law and economics logic of the Alito opinion such that Thomas could concur? Flannigan found that various conceptions of fiduciary responsibility bewilder jurisprudence. And Flannigan cautioned that one snare is the view that fiduciary regulation reaches assessing the fairness of an exercise of "authority, notwithstanding the absence of . . . self-dealing." Such befuddlement plagues this corner of the law. Sure enough, the unbefuddled Justice Alito in Jones recalled that in concocting the 1970 amendments, Congress rejected an investment adviser compensation reasonableness standard. And the unbefuddled Justice Thomas concurred to revile a freewheeling judicial fairness review of fees.

Make no mistake: "The conventional function of fiduciary regulation is [controlling the] opportunism [to be found] in limited access arrangements." Such an arrangement obtains if one party acquires access to another's assets toward a defined or limited goal. The backdrop to conventional fiduciary duty is such arrangement of limited access. In agency, the fiduciary-agent's duty to forgo her self-interest in exploiting the aforementioned limited access is a duty required by definition: For it is this shunning self-interest that limits the access. Recall Flannigan’s insistence re-

453. Id. at 400 n.23.
455. Flannigan, The Economics of Fiduciary Accountability, supra note 58, at 410.
456. Id.
457. Id.
459. See id. at 1431 (Thomas, J., concurring).
460. Flannigan, The Economics of Fiduciary Accountability, supra note 58, at 393.
461. Flannigan, Fact-Based Fiduciary Accountability in Canada, supra note 57, at 432 n.3.
462. Id. at 443.
463. Id. at 440. "The duty of loyalty is the distinctive feature of fiduciary law—the entailment of the vulnerability of the beneficiary to the fiduciary's discretion in using or working with a critical resource (such as information) belonging to the beneficiary." HANOCH DAGAN, THE LAW AND ETHICS OF RESTITUTION 236 (2004) (emphasis added) (citing D. Gordon Smith,
counted in Section VIII C, supra, upon fiduciary duty as a proscription. Proscribed is exploiting limited access in self-interest.

Flannigan’s insight—that the conventional function of fiduciary regulation is the control of limited access arrangement-opportunism—isolates the implicit logic of Alito and Thomas in comprehending the captive mutual fund-investment adviser duet. Advisers wield discretionary power in an access sense, in certain aspects. Crucially, they enjoy access to the beneficiary’s judgment—for nurturance of the beneficiary’s judgment is the nature of advice. That function may be exploitable. Therein arises the capacity to exercise a discretion to extract gain beyond that authorized—a de facto power. In this sense proves discretionary power manifestly one of limited access.

More specifically and crucially, the investment adviser enjoys access to a captive mutual fund board’s judgment at least by hypothesis. Therein arises the investment adviser’s capacity to extract profit beyond that authorized to a fiduciary—a de facto power at least by hypothesis. Such was the sin alleged in Jones against Harris Associates L.P. Therefore could Alito and Thomas in Jones fuel the enforcement of the investment adviser’s fiduciary duty while heartily disclaiming judicial enforcement of any nebulous reasonableness/fairness standard

B. Mirrlees and Frankel on Agency/Fiduciary Duty

In his capacity as a juridical scientist, Judge Easterbrook and his co-author Fischel fancy the rationale for fiduciary duty as judicial finessing of impossibly onerous transaction costs (as indicated in Section III, supra). Disavowed was the proposition that fiduciary duty redresses informational or power inequalities between contracting parties. Nevertheless, in his own capacity as a juridical scientist, Judge Posner doggedly insists that the fiduciary principle indeed is the law’s reply to the problem of unequal information costs. On the other hand, Flannigan points out that opportunism just


464. Flannigan, Fact-Based Fiduciary Accountability in Canada, supra note 57, at 454.

465. Id.

466. Id.

467. Id. at 455.

468. Id.


470. Easterbrook & Fischel, supra note 42, at 438, 444–46; see also supra Section III

471. Id. at 436.

472. POSNER, ECONOMIC ANALYSIS OF LAW, supra note 139, at 114.
cannot be stamped out through complete contracting with full information. Expected repeat interactions dampen opportunism. But agents pursue self-interest when they spontaneously opt to treat their relation as an end game. And markets prove inadequate in addressing end game interactions.

1. The Theory of First-Mover Vulnerability

Sir James A. Mirrlees, in 1996, was awarded the Alfred Nobel Memorial Prize in Economics for his work on economic behavior [where] there is incomplete information. The Royal Swedish Academy of Sciences honored Mirrlees, and William Vickery, "for their fundamental contributions to the economic theory of incentives under asymmetric information." Mirrlees' approach notably had proved meritorious in moral hazard situations like that of principal-agent. Therefore might one presume some Mirrlees sympathy for Posner's unequal information costs rationale for fiduciary duty, whether or not one presumed a Mirrlees sympathy for the Easterbrook-Fischel transaction costs version of the rationale.

However, Mirrlees declares, "It is not so much the asymmetry of information that is special about principal-agent relationships, but the asymmetry of responsibilities, with the principal moving first, the agent following." Might this Mirrlees principal-agent finding feed into Jones? True, while each agent is a fiduciary, not every fiduciary is an agent. The Mirrlees principal first-move insight well might nourish the understanding of Jones. Boston University School of Law Professor Tamar Frankel is an expert in fiduciary law, in the regulation of money managers, mutual funds, and

473. Flannigan, The Economics of Fiduciary Accountability, supra note 58, at 407. After all, opportunism ordinarily erupts in violation of the contract. Id. at 406.
474. Id. at 407 n.55.
475. Id. at 407.
476. Id. at 415.
480. Id.
482. Casadesus-Masanell & Spulber, supra note 51, at 68 (citing Easterbrook & Fischel, supra note 42).
483. See, e.g., TAMAR FRANKEL, FIDUCIARY LAW: ANALYSIS, DEFINITIONS, RELATIONSHIPS, DUTIES, REMEDIES OVER HISTORY & CULTURES (2008); Tamar Frankel, Fidi-
advisers, and in investment management regulation. In August 2009, Professor Frankel explained that fiduciaries may dispose of, as they like, the compensation they win for their services:

The problem arises when fiduciaries have significant influence on the amount that they receive as compensation for their services. This situation occurs when client-entrustors are incapable of freely and independently agree to the commissions or the fees for the services. In such cases these commission payments are an exchange in form but not in substance. The greater the entrustment, the more numerous are the entrustors, the less free bargaining power the entrustors may have. In such cases the law might interfere in containing the fiduciaries’ compensation. This is especially so when the entrustors will sustain costs in severing the relationship, for example, pay taxes on amounts that would otherwise be tax deferred.

At this juncture, Frankel adds a footnote: “For example, mutual fund investors are numerous and have no opportunity to negotiate the fees they charge. Redemption of mutual fund shares invested in a pension fund may involve for entrustors high taxes.”

Frankel’s mutual fund investors, having—as Mirrlees would say—moved first by entrusting their retirement money to a mutual fund, experience no opportunity themselves to negotiate over fees charged. Worse, they also are hostages vulnerable to costs entailed—e.g., taxes on sums otherwise tax-deferred—in an escape from their agent. Remember Flannigan’s insistence, recounted in Section XI A, supra, that fiduciary regulation checks the opportunism embedded in limited access arrangements. Not only is an adviser’s discretionary power manifestly a power of limited access abstractly, but also Mirrlees’ first-mover mutual fund investors hostage—as Frankel suggests—to the second-mover adviser, are extraordinarily exposed to opportunism.

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487. Id. (footnote omitted).
488. Id. at 8 n.29.
2. The Practice of First-Mover Vulnerability

How closely might the Mirrlees-Frankel logic parallel the facts of *Jones*? In the November 2nd oral argument, Chief Justice Roberts shared this exchange with David C. Frederick, appearing on behalf of the *Jones* petitioners:

MR. FREDERICK: Here what is happening is that an arm's-length transaction for the same services—the same manager is going out and touting his services to the institutional investor, but simply charging them half as much money for providing the same portfolio of management.

CHIEF JUSTICE ROBERTS: Do technological changes make a difference in terms of disclosures required? These days all you have to do is push a button and you find out exactly what the management fees are. I mean, you just look it up on Morningstar and it's right there and you can make—as an investor you can make whatever determination you'd like, including to take your money out.

MR. FREDERICK: The fact that an investor may know going in what the fee is does not address the problem Congress was intending to address, which is that as larger and larger sums of assets were accreted to the mutual fund, the investor was not obtaining the benefits of economies of scale. And that's the central point—

CHIEF JUSTICE ROBERTS: So we could look at—you know, as the fund grows bigger and he doesn't get those benefits he can go look at another fund. It takes 30 seconds.

MR. FREDERICK: And that again doesn't address the problem Congress was trying to get at, which is to protect the company, not the individual investor. The individual investor might lessen the damages that that investor suffers, but the fund, the people remaining, continue to pay excessive fees.

JUSTICE SCALIA: No, but he protects the company ultimately, because when investors leave the company that is charging excessive fees to go to other companies, the company that they are leaving sees that something's wrong and has to lower its compensation to its adviser. Why doesn't that affect the company at issue?

MR. FREDERICK: A large number of assets under management in mutual funds, something like 26 to 35 percent according to ma-
terials that are in the record, are from 401(k) plans, where the investor is essentially locked into the fund that his or her company chooses to make that investment. And even as to investors who are not locked in, there are significant tax consequences where over time an investor might be in the Oakmark Fund and have to suffer large tax consequences in order to get the benefit of the statute—\textsuperscript{489}

The mutual-fund, the individual investors therein, moves first. Investors invest in their mutual fund, which hires an investment-adviser. Thereafter, those investors fail to net the benefits as increasingly heftier sums accrete to their fund. The investment-adviser, moving second, now charges these mutual fund investors double its price to institutional investors, for a comparable portfolio of management. The agent-adviser would lack the funds to manage had investors not moved first. The Jones facts fit like a glove with the Mirrless-Frankel logic. Understandably, Frankel responded to Jones, ‘‘If the industry doesn’t do anything in response to this ruling,’’ then plaintiff investors in captive mutual funds ‘‘will have a better time.’’ \textsuperscript{490}

True, individual investors who recoil from being burned can abandon their flaming investment. Nonetheless, the fund and investor-principals persevering in the relationship, who supposedly are legally protected from adviser predation by their adviser’s fiduciary duty relative to compensation, continually pay extreme fees. Correspondingly, when Mirrlees identified the special component of principal-agent relationships as the principal moving first and the agent following, Mirrlees emphasized that many economic problems and possibilities involve the relationship such as taxation, contracts, bargains, and thefts.\textsuperscript{491}

C. Jones on Fiduciary Duty

Was it in the spirit of the Ninetieth Congress, delivering investors the section 36(b) guarantee of security from adviser predation through that adviser’s fiduciary duty as to compensation, that the traduced investor should

\textsuperscript{489} Transcript of Oral Argument, \textit{supra} note 277, at 12–14 (emphasis added). Finally, the contention that shareholders are free to move to another, less costly fund at any time overlooks two facts:

The initial purchase of a fund probably incurred sales charges, and another charge is likely when buying a different fund. At the same time, the sale of a fund is likely to trigger a taxable event.

Both factors effectively penalize cost-conscious investors—which is simply unfair.

\textsuperscript{490} Calabria, \textit{supra} note 416, at 8.

\textsuperscript{491} Mamudi, \textit{supra} note 378.

The initial purchase of a fund probably incurred sales charges, and another charge is likely when buying a different fund. At the same time, the sale of a fund is likely to trigger a taxable event. Both factors effectively penalize cost-conscious investors—which is simply unfair.
simply sell out? In fact, there is some indication that Congress in the Investment Company Act endeavored to secure the investor-mutual fund relationship from predatory advisers who could leave scorched investors nothing but retreat from their mutual fund.\textsuperscript{492} Such retreat would mean a kind of marketplace waiver of their statutorily-guaranteed right to their mutual fund adviser's fiduciary duty in regard to their compensation. Section 47 of the Act ordains:

(a) Waiver of compliance as void

Any condition, stipulation, or provision binding any person to waive compliance with any provision of this title or with any rule, regulation, or order thereunder shall be void.

(b) Equitable results; rescission; severance

(1) A contract that is made, or whose performance involves, a violation of this subchapter, or of any rule, regulation, or order thereunder, is unenforceable by either party (or by a nonparty to the contract who acquired a right under the contract with knowledge of the facts by reason of which the making or performance violated or would violate any provision of this subchapter or of any rule, regulation, or order thereunder) unless a court finds that under the circumstances enforcement would produce a more equitable result than nonenforcement and would not be inconsistent with the purposes of this subchapter.

(2) To the extent that a contract described in paragraph (1) has been performed, a court may not deny rescission at the instance of any party unless such court finds that under the circumstances the denial of rescission would produce a more equitable result than its grant and would not be inconsistent with the purposes of this subchapter.

(3) This subsection shall not apply (A) to the lawful portion of a contract to the extent that it may be severed from the unlawful portion of the contract, or (B) to preclude recovery against any person for unjust enrichment.\textsuperscript{493}

Focusing as Congress did upon equity, did Congress disdain the investor alternative of selling away her right to her fund adviser's performance of fiduciary duty? In Jones, the Supreme Court responded to a fiduciary rela-


tionship wherein the first-moving investors could be held hostage—e.g., through a threatened taxation of money otherwise tax-deferred—by an ince
tuous, second-moving mutual fund-investment adviser dyad. Comparison of the advisory fees charged to captive mutual funds against fees charged to independent clients had been a concept belittled in the influential Gartenberg precedent. The Securities and Exchange Commission ostensibly is deputized to effectuate the Congressional will through championing investors against investment adviser breach of fiduciary duty. That commission engaged in double-negative nods and winks to satisfy investment advisers that mutual fund boards were neither tasked with the study of any captive mutual fund/independent client fees contrast nor tasked with informing those boards’ own innocent investors that their board had failed to make such comparison.

The Alito opinion in Jones sagely reacted to this pronounced vulnerability of the first mover to the second. It fortified the 1970 Act by confirming that the investment adviser’s fiduciary duty therein proves of such import that Jones: (1) foreclosed the categorical denial of the captive mutual fund/independent client fees comparison; (2) backed courts away from over-reliance upon those fees charged to mutual funds by other advisers—the imperative behind their warning, spelled out by the Supreme Court advancing without a single dissent, is that to do so could tend to overly-insulate investment advisers from section 36(b) liability—and; (3) summoned judicial evaluation of a mutual fund board’s consideration of the relevant factors behind the investment advisory fee it approves, the more aggressively for courts to examine the outcome should a board’s consideration be deficient (procedure); and (4) further affirmed the role of the judge in repudiating a fee as uncalled-for even when negotiated by a board possessed of all relevant information (substance). Jones holds that the section 36(b) standard of fiduciary breach excludes the judiciary’s second-guessing of informed board decisions, apparently to be distinguished from simply those decisions delivered by a board advised of the relevant data. Atop this, Justice Thomas’ concurrence stipulates that the Jones opinion incarnating these features “does not countenance the free-ranging judicial ‘fairness’ review,” which Congress definitively discarded in 1970.

495. Id. at 1430–31.
496. Id. at 1431 (Thomas, J., concurring).
The preceding discussion has reviewed the 2010 Jones v. Harris Associates L.P. Supreme Court opinion by Justice Alito. It beckoned future lawsuits brought by mutual fund shareholders challenging the fees paid to the investment advisers of their funds. Such advisers erect the captive mutual funds they then advise and dominate. The Investment Company Act of 1940, as amended in 1970, laid upon the investment adviser of a registered investment company a fiduciary duty as to that adviser’s services compensation laid out by such company. The extent, or even the existence, of private, plaintiff-driven litigation to enforce federal enactments is in great measure the outcome of Congressional choice among options of statutory design.\textsuperscript{497} Large-scale Congressional interventions into the marketplace can pivot, instead, upon bureaucratic enforcement regimes, entailing administrative investigations, hearings, and issuance of orders.\textsuperscript{498}

The model of rational litigant behavior as developed in the literature of law and economics hearkens to a plaintiff’s expected monetary benefit (EB), expected litigation costs (EC), probability of victory (p), and the perceived claim’s consequent monetary value (EV).\textsuperscript{499} These variables impinge likewise, of course, upon her for-profit sector attorney’s evaluation of his case.\textsuperscript{500} Exploiting this law and economics formula for the litigation decision (EV = EB(p) - EC) illuminates systematically the means whereby Congress can regulate the volume of private enforcement litigation. Congress twists the volume-dials by manipulating the anticipated dollar payoff from lawsuits.\textsuperscript{501}


\textsuperscript{498.} FARHANG, supra note 497, at 3.

\textsuperscript{499.} Id. at 22.

\textsuperscript{500.} See id. at 23–24.

\textsuperscript{501.} Id. at 25. Farhang analyzes from the perspective of new institutionalism in political science, in his stress upon political/strategic/policy forces impelling statutory design outcomes. Id. at 24. These variables can explain the resultant nativity of a statute that is quite inefficient economically. FARHANG, supra note 497, at 24. In any event, the new institutionalism emergent a generation ago, see, e.g., James G. March and Johan P. Olsen, THE NEW INSTITUTIONALISM: ORGANIZATIONAL FACTORS IN POLITICAL LIFE, 78 AM. POL. SCI. REV. 734 (1984), the dominant political science approach since 1990, MARK BEVIR & R.A.W. RHODES, THE STATE AS CULTURAL PRACTICE 25 (2010), and now the leading expression of modernist-
And *Jones* arrived at the Supreme Court only following dueling in the United States Court of Appeals for the Seventh Circuit by such swashbucklers of law and economics as Chief Judge Frank H. Easterbrook and Judge Richard A. Posner.

B. *Jones Steers America Aright*

*Gartenberg*, an opinion from the United States Court of Appeals for the Second Circuit, so read the fiduciary duty feature of the 1970 amendments that subsequent litigation in exorbitant fee controversies elicited judgments nearly uniformly for defendants. Thereafter, economic analysis of law heavyweights Easterbrook and Daniel R. Fishel propounded that naught special adheres to the fiduciary relationship. Fiduciary duty is instead a transaction-cost function. In *Jones*, Chief Judge Easterbrook reacted to an attack under the amendments to the Investment Company Act from shareholders in mutual funds against their captive funds’ adviser’s recompense. His opinion hearkened virtually altogether to the feature of the fiduciary adviser’s disclosure to its captive mutual fund’s board. Both the intermediate-court appellate opinions in *Gartenberg* and *Jones* snorted at respective plaintiff pushes to benchmark investment advisory fees levied upon their captive mutual funds against fees imposed on independent clients, e.g., pension funds. In dissenting from a *Jones* denial of a rehearing en banc, Judge Posner concentrated rather upon an adviser’s charging its captive funds over twice what it charged to independent funds.

The Alito opinion opted less for the Easterbrook rationale in *Jones* than for the *Gartenberg* route. To run the risk of liability for its breach of fiduciary duty, the investment adviser must amass compensation so disproportionately great as to entail no reasonable relation to the rendered services: the fee cannot be the fruit of an arm’s-length bargain. Yet Alito gives birth to a *Gartenberg*-plus opinion. *Jones* disavows any categorical rule bar against comparisons between those fees an adviser levies upon a captive mutual fund and fees it charges its independent clients. Justice Alito expounds that fees can be excessive even when negotiated by a board in possession of all relevant information.

Comprehended at once by numerous commentators was the potential impact of Alito’s *Gartenberg*-plus opinion in *Jones*. The bottom line: There might be mounting pressure on the investment advisers of captive mutual

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fund boards to make detailed accountings of, and perhaps reductions of, their investment advisory charges. Any such pressure would redound to the financial benefit of retail rather than to institutional investors. Disappointingly, such salutary payoffs as might be hoped-for from Jones had not already been laid on the table for investors by the Securities and Exchange Commission. The naïve might believe themselves watched-over by a benign, guardian-angel S.E.C. But that blind administrative-watchdog slumbers.

This Alito opinion in Jones snugly squares with the law and economics thinking posited neither by Easterbrook—with a linking of fiduciary duty with transaction costs—nor by Posner, who ties the fiduciary duty to the unequal information costs problem. It rather comports with contributions of Nobel laureate economist Sir James A. Mirrlees, and of the fiduciary law scholar Tamar Frankel of Boston University. The former comprehends the distinguishing element of principal-agent relationships to be asymmetry in responsibilities, with the principal as first mover and the agent as the second. Frankel perceives that first mover-mutual fund investors (principals) might become hostages of the lupine second mover-investment advisers (agents).

The Jones advance beyond Gartenberg is probably, if tenuously, for the best from a libertarian perspective. As the law and economics scholar and expert in the law of fiduciary duty Nicholas L. Georgakopoulos502 frames it:

[C]ontracting parties cannot create levels of fiduciary obligations outside the two choices: arm’s-length or fiduciary relations. That is, parties cannot agree to give the investor fewer opportunities than a pure arm’s-length relationship or more opportunities than a pure fiduciary relationship. The farther apart the legal system keeps the definitions of the two, the more latitude parties have to fine-tune their relationships. In order to expand contracting choices, the two levels of loyalty available must be kept as far apart as possible.503

At least as a general principle, free market contracting must welcome strong enunciations of fiduciary duty.504

503. Id. at 153.
504. Also, even acclaimed scholars of law and economics can assert that a widely-sensed impulse of conscience, and not merely some presumably-widespread application of cost-benefit analysis, see, e.g., Matthew D. Adler & Eric A. Posner, Implementing Cost-Benefit Analysis When Preferences Are Distorted, 29 J. LEGAL STUD. 1105 (2000), properly is to be heeded by the architects of legal frameworks. See generally Lynne Stout, Cultivating Conscience: How Good Laws Make Good People (2011).