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Jones v. Harris: Standing Up for Directors

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by Michael Scofield

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A funny thing happened on the way to the United States Supreme Court: The independent directors who represent shareholders in America's mutual funds all disappeared.

That's the impression someone would get if all he or she knew about mutual funds was what she read in the papers filed by the plaintiffs in Jones v. Harris Associates. The lawyers who are suing Harris, adviser to the Oakmark Funds, have erased the thousands of dedicated women and men who serve on fund boards, spend countless hours overseeing their funds' performance and services, and approve each fund's advisory contract, including the adviser's fees.

When they go to the Supreme Court to argue Jones v. Harris on Nov. 2, these lawyers want to convince the justices that there's a gap in fund governance. And who should rush in to fill this void? Why, the plaintiff's bar and federal judges, of course. The lawyers for the Jones side want to turn every advisory fee agreement for every fund into a federal court case, driving up costs and diminishing choice and services for retail investors.

As independent chairman of the Evergreen Funds and chairman of the Independent Directors Council, I want the justices to know about independent directors and the crucial role we play in protecting the interests of almost 90 million fund shareholders. That's why IDC was one of the many parties — including the Mutual Fund Directors Forum, the Investment Company Institute and the U.S. Chamber of Commerce — to file a "friend of the court" brief to correct the distorted record that the plaintiff's lawyers are pushing.

The high court is being asked to decide who should approve fund fees on an ongoing basis. In 1940 and again in 1970, Congress gave the job to independent directors. A 1982 decision by the U.S. Second Circuit Court of Appeals—Gartenberg v. Merrill Lynch—correctly followed Congress's lead and instructed courts to consider claims against an adviser's fee in light of a variety of factors, taking into account the independent directors' contract approval.

Gartenberg has worked well for mutual fund boards and the shareholders they represent. It allows courts to weed out meritless claims before trial, while ensuring that boards protect their investors by reviewing advisory contracts and fees in terms of the quality of services rendered and the fees charged to comparable funds.

But it doesn't work for the class action attorneys. The lawyers behind Jones v. Harris would rather open the courthouse door to annual lawsuits over virtually every fund's advisory fee. Fund advisers and directors could spend countless hours responding to lawyers' questions rather than investors' needs. Investors would pick up the tab. The mutual fund industry would become fertile ground for fee litigation, reducing choice and increasing costs for investors as some advisers leave the field and others are forced to raise fees to pay their legal bills.

Judges can't possibly exercise the same oversight as fund independent directors, who operate within the most comprehensive regulatory regime applied to any financial product. And, as Securities and Exchange Commissioner Troy Paredes recently noted, "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."

Fund boards, by contrast, bring independent and expert business judgment to bear, along with a watchful eye. On 90 percent of boards, 75 percent or more of directors are independent. Most boards are chaired by an independent director or have a lead independent director.

Directors spend months studying information relating to their fund adviser's contract. They review reams of data on fund performance, costs, services, and other factors, comparing each fund's fees to its competitors'. And they're held accountable: the SEC requires every fund to disclose to investors the factors its board considers and the basis of its approval for advisory contracts, and to turn over to SEC examiners copies of all written materials that the board considers.

This vigorous board oversight is backed up by one of the most important elements in any market—competition for the business of cost-conscious consumers. The impact of this healthy balance of independent boards and informed investors is clear. Since 1980, the fees and expenses paid by mutual fund investors are down 57% for equity funds and 63% for bond funds.

I'll be at the Supreme Court on November 2, offering silent witness to the crucial role that my thousands of colleagues on fund boards play. I want the court to know that we're the "independent watchdogs" that it charged us to be—and there's no need for lawyers and judges to take over that job.

Extensive background information is available on the Jones v. Harris Resource page.
