ICI MUTUAL NEWSLETTER

Claims Trends

A Review of Claims Activity in the Mutual Fund Industry (January 2013-March 2014)

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Abbreviations used in this *Claims Trends*:

'33 Act	Securities Act of 1933
'34 Act	Securities Exchange Act of 1934
CFTC	U.S. Commodity Futures Trading Commission
Dodd-Frank	Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
ERISA	Employee Retirement Income Security Act of 1974
FINRA	Financial Industry Regulatory Authority
IAA	Investment Advisers Act of 1940
ICA	Investment Company Act of 1940
NFA	National Futures Association
OCIE	Office of Compliance Inspections and Examinations of the SEC
RICO	Racketeer Influenced and Corrupt Organizations Act
Sarbanes-Oxley	Sarbanes-Oxley Act of 2002
SEC	U.S. Securities and Exchange Commission

In addition, U.S. Courts of Appeals are referred to by their circuit number (e.g., First Circuit, Second Circuit).

Introduction

ICI Mutual's annual *Claims Trends* reports on significant regulatory proceedings, civil lawsuits, and operational errors affecting the fund industry. *Claims Trends* is designed to assist ICI Mutual's insureds in better assessing and managing the risks associated with such matters, thereby reducing the potential for associated losses and reputational damage.

Over the past decade, unprecedented scrutiny of the fund industry by state and federal regulators and by the plaintiffs' bar (i.e., private lawyers who specialize in seeking large-scale recoveries from financial institutions on behalf of investors) has spawned scores of regulatory investigations, regulatory enforcement actions, and shareholder lawsuits involving fund advisers, funds, and fund directors and officers. With most of these matters now concluded (or nearly so), ICI Mutual's experience suggests that the fund industry may be entering a "new normal" period for claims. In this environment, the SEC and other regulatory authorities can be expected to continue their aggressive enforcement programs. At the same time, the plaintiffs' bar, while perhaps more selective in its attacks than in the past, can also be expected to remain a potent threat.

ICI Mutual measures claims activity by both *frequency* and *severity*. With regard to *frequency,* approximately a fifth of the fund groups insured by ICI Mutual submitted at least one claim notice in 2013 under their directors and officers/errors and omissions (D&O/E&O) policies. This figure reflects a downturn in the overall number of new claims from 2012.

Unlike frequency, the *severity* of new claims can be difficult to assess, particularly for civil lawsuits and regulatory proceedings, where the magnitude of losses (including defense costs, settlements, or judgments) may take years to establish. Even so, severity remains a concern for the industry, as evidenced in 2013 and early 2014 by the initiation of a number of new shareholder lawsuits alleging "excessive fees," and by additional multimillion dollar public settlements announced in disclosure-related lawsuits that were first initiated during the credit crisis and post-credit crisis period.

2013 and early 2014 also witnessed significant regulatory enforcement activity, chiefly by the SEC, in the asset management area. While the overall number of asset management-related enforcement actions brought by the agency in its 2013 fiscal year did not match the agency's record-breaking numbers in 2011 and 2012, the 2013 total remained above the agency's pre-2011 totals. Statements by SEC representatives suggest that close scrutiny of the asset management area, including the registered fund sector, is likely to continue in 2014.

For fund groups faced with civil litigation and/or regulatory proceedings, legal defense costs remain substantial. ICI Mutual's claims experience indicates that defense costs—particularly in SEC regulatory investigations and in shareholder litigation initiated by the plaintiffs' bar—can quickly reach seven figures for affected fund groups and, in some cases, can climb into eight figures.

As in prior editions, this publication reports on developments in four perennial risk areas for fund groups: (1) *regulatory* investigations, administrative proceedings, and/or litigation initiated by the SEC or other federal or state authorities; (2) *fee* claims by fund shareholders challenging fees received by advisers and other service providers; (3) *disclosure* claims by fund shareholders challenging the accuracy or adequacy of disclosures made by funds and

advisers; and (4) liabilities for *operational errors* committed by advisory personnel or other individuals or entities in the portfolio management process.

This *Claims Trends* also reports on efforts by private litigants to target fund advisers and fund directors in civil litigation alleging violations of state (rather than federal) law, and reviews certain other noteworthy litigation developments from 2013 and early 2014.

Regulatory Enforcement

As noted in the Introduction, 2013 and early 2014 witnessed significant regulatory enforcement activity, most notably by the SEC, both in the asset management area in general, and in the registered fund space. Developments at the SEC and recent public remarks by SEC officials suggest that enforcement scrutiny of entities and individuals in this area—including registered funds, fund advisers, fund boards (including independent directors), and other associated individuals—is likely to continue in 2014.

SEC Enforcement Actions

2013 brought significant changes in the SEC's top personnel and, with those changes, a renewed emphasis by the agency on enforcement efforts.

In April 2013, Mary Jo White became Chair of the SEC, bringing with her long experience as a litigator, both as U.S. Attorney for the Southern District of New York and as the head of a well-regarded law firm's litigation department.[1] In October 2013, in a highly publicized speech, Chair White announced the SEC's "broken windows" initiative—designed to enhance the agency's enforcement presence, and under which the agency would focus on pursuing securities law violations both large and small.[2] The stated goal of this approach was to ensure that "the SEC's enforcement program is—and is perceived to be—everywhere." Chair White has since consistently reiterated her emphasis on enforcement, and public statements from other commissioners and SEC officials have echoed Chair White's enforcement theme.[3]

Asset management remains a key focus of the SEC's enforcement efforts. Four years ago, the SEC created a specialized asset management unit in its Enforcement Division, and in the agency's 2013 fiscal year, enforcement actions in this area accounted for approximately 20% of all enforcement actions brought by the agency. The number of asset management-related enforcement actions instituted by the SEC in 2013 (140 out of 686 total) nearly matched the agency's record total (reached in its 2012 fiscal year) and remained substantially above pre-2011 totals.[4]

As in prior years, most of the SEC's enforcement actions in the asset management area in 2013 and early 2014 focused on actors outside the registered investment company space. But as in the past, advisers and distributors to registered funds and their associated personnel were by no means immune. And in perhaps the most high-profile SEC enforcement actions in the registered fund space in recent years, the SEC reached resolutions in 2013 in two enforcement actions against fund independent directors—the first such actions brought against fund independent directors in many years.[5]

NOTABLE ADMINISTRATIVE PROCEEDINGS

Enforcement proceedings initiated or resolved by the SEC in 2013 and the first quarter of 2014 against fund advisers, advisory personnel, and/or fund officers involved various issues, including: material misrepresentations and omissions in public disclosures;[6] misrepresentations and omissions in connection with the advisory contract approval process;[7] misleading a money market fund board regarding portfolio risk;[8] and cross-trading violations.[9]

SEC enforcement proceedings were also initiated or resolved against fund advisers and/or advisory personnel with respect to their *non*-registered fund activities. These proceedings likewise involved various issues, including failure to disclose violations of an issuer-imposed investment restriction;[10] failure to disclose conflicts of interest in selecting portfolio securities;[11] valuation of portfolio holdings;[12] trading on the basis of material, non-public information;[13] and code of ethics violations in connection with personal securities trading.[14]

From a fund industry perspective, however, perhaps the most notable enforcement development of recent years came in 2013, with the settlements of two SEC actions against fund independent directors.

In May 2013, the SEC settled administrative proceedings with five trustees (including independent trustees) of two multiple series trusts, over charges that the trustees had failed to satisfy their obligations with regard to the annual advisory contract approval process.[15] The SEC found that the trusts' shareholder reports included false statements and omitted material information regarding the factors the trustees considered in reaching their decisions.[16]

Separately, in June 2013, the SEC reached a final settlement in administrative proceedings against eight former mutual fund directors (including six former independent directors) over charges that the directors had failed to satisfy their obligations with respect to the "fair valuation" of certain portfolio securities held by their funds during the credit crisis period.[17]

These two actions against fund independent directors have generated significant discussion in the fund industry—both for what they may mean with regard to the SEC's view of fund directors' responsibilities, and for what they may portend with regard to future SEC enforcement activity in the registered fund space.[18] Some agency officials have expressly sought to reassure fund boards that the recent SEC actions do not "represent a target on the board's back."[19] Despite such reassurances, other recent comments by SEC officials, including Chair White, have promised continued attention to "gatekeepers," including fund boards.[20]

SELECTED FEDERAL COURT CASES

2013 witnessed the conclusion to a lawsuit initiated by the SEC involving a money market fund that "broke the buck" during the financial crisis. In 2012, following a trial in federal court, a jury had cleared two principals of fraud charges, but had found that the adviser itself committed fraud and that one of the principals had been negligent.[21] In September 2013, the court ordered the adviser and the one principal to pay civil penalties.[22] Thereafter, the lawsuit was dismissed in January 2014.[23]

In 2013, the Seventh Circuit issued an opinion in a novel case involving charges of insider trading in connection with the redemption of mutual fund shares by an individual who served as a fund officer and as the adviser's chief compliance officer and general counsel. The matter dates back to 2003,

when the SEC sued a municipal bond fund adviser, as well as several of its executives, for insider trading and other violations of securities laws. The SEC had alleged that the defendants had fraudulently inflated the prices of bonds held by certain municipal bond funds, and that certain defendants had redeemed their fund shares prior to the devaluation of the bonds. In 2008, following settlement with the SEC, the claims against all defendants, except for one individual defendant, were dismissed with prejudice.[24]

In 2011, the district court ruled that the remaining individual defendant had engaged in insider trading.[25] On appeal, the Seventh Circuit reversed the district court's decision, and remanded the lawsuit to the district court for additional consideration of the novel issue whether "insider trading theories apply to mutual fund redemptions."[26] The lawsuit is now before the district court, and the defendant's motion for summary judgment, filed in October 2013, remains pending.[27]

Influences on Future SEC Enforcement Actions

2013 and early 2014 saw a number of developments with the potential to shape SEC enforcement in the coming years. As discussed below, these developments include: (1) a change in the SEC's policy regarding use of "neither admit nor deny" settlements in regulatory enforcement actions; (2) a continuing evolution of the SEC's whistleblower program; (3) the expanded use of deferred prosecution agreements; and (4) a U.S. Supreme Court decision limiting the period of time within which the SEC may initiate actions seeking civil penalties.

"NEITHER ADMIT NOR DENY" SETTLEMENTS

Historically, the SEC has viewed "neither admit nor deny" settlements—in which entities and individuals are permitted to "neither admit nor deny" the SEC's allegations against them in reaching settlements with the agency—as "both common and sound public policy,"[28] and has utilized them to resolve enforcement actions in the fund industry and elsewhere. As discussed in prior *Claims Trends*, several federal lower court judges have, in recent years, questioned such settlements.

In June 2013, the SEC staff announced that the agency would begin, even in cases not involving criminal charges, to seek "admissions of wrongdoing" in cases of egregious intentional misconduct, misconduct that harmed or had the potential to harm large numbers of investors, and/or obstruction of the SEC's investigative processes.[29] Pursuant to this revised policy, the SEC obtained admissions of wrongdoing in three settlements in 2013, none of which involved registered funds or their advisers.[30]

Chair White has indicated that the SEC will continue to seek admissions of wrongdoing, where appropriate, in reaching settlements of enforcement actions in 2014, but has stated that the SEC will exercise its "independent discretion" (and will resist judicial and other outside pressure) in determining when to demand such admissions.[31] It remains to be seen how, if at all, the SEC may apply this revised policy in the registered fund space.

WHISTLEBLOWER PROGRAM

The SEC's Office of the Whistleblower completed its second full year of operations in 2013. The SEC's whistleblower program provides significant financial incentives for corporate insiders and others to report tips to the agency. In fiscal year 2013, the Office of

the Whistleblower fielded over 3,000 tips, bringing the total to over 6,500 since the whistleblower program began.[32]

In fiscal year 2013, the SEC also awarded four "bounties" to whistleblowers, including its largest to date.[33] Based on available information, it does not appear that any bounty awarded to date has involved a whistleblower in the registered fund space.[34] Even so, some industry observers continue to believe that the program may lead to an increase in enforcement actions in the fund industry in the years ahead.[35]

DEFERRED PROSECUTION AGREEMENTS

The SEC recently expanded its use of deferred prosecution agreements ("DPAs"), under which the agency agrees not to prosecute entities and individuals (subject to their compliance with certain conditions) in return for their cooperation with the SEC. Prior to 2013, the SEC had entered into DPAs with entities only. In 2013, the SEC entered into its first DPA with an individual, who aided the SEC in halting fraud at a hedge fund and in recovering investor assets.[36]

STATUTE OF LIMITATIONS

The U.S. Supreme Court issued a decision in February 2013 that limits the period of time within which the SEC may initiate fraud actions seeking civil penalties. The Court ruled that the SEC must bring such actions within five years from the date of the *occurrence* (not the *discovery*) of the alleged fraud.[37]

The Court's decision did not address the limitations period for actions seeking remedies other than civil penalties (such as injunctive relief).[38] Even so, some industry observers have suggested that the decision may prompt the SEC, in the future, to hasten its investigations and/or to seek tolling agreements (suspending the statute of limitations) from individuals and organizations under investigation.[39] The decision may also limit the SEC's ability to pursue additional fraud actions based on conduct that occurred during the credit crisis period.[40]

Enforcement Actions by Other Regulators

The SEC is not the only regulator that may institute enforcement actions against fund advisers and distributors, funds, or fund directors and officers. State regulators continue to monitor the fund industry. In October 2013, the Massachusetts state securities division reportedly sent inquiry letters to certain fund advisers with respect to municipal bond fund disclosure regarding risks associated with holding Puerto Rican debt.[41] On occasion, ICI Mutual has also received claim notices relating to investigations by foreign regulators.

ICI Mutual also receives, from time to time, claim notices relating to FINRA investigations involving the distribution of fund shares and fund marketing materials. FINRA's interest in issues affecting the fund industry is likely to continue, as reflected in FINRA's annual letter setting forth regulatory and examination priorities. For 2014, these priorities include: (1) suitability issues with respect to the concentrations of certain securities in bond funds; (2) disclosure related to investments that are vulnerable to rising interest rates; (3) the use of social media to interact with retail investors; (4) cyber security and data breaches; and (5) anti-money laundering.[42]

Fees

Over the years, the plaintiffs' bar has often challenged fees charged to mutual funds by

investment advisers and other service providers. These lawsuits frequently allege violations of section 36(b) of the ICA, which provides that 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," and expressly provides shareholders with the right to bring a lawsuit to enforce this duty.[43] Fees have also been challenged under other theories, including under ERISA and as state law claims for breach of fiduciary duty.

Section 36(b)

In 2010, the U.S. Supreme Court, in Jones v. Harris Associates, L.P., affirmed use of the longtime "*Gartenberg* standard" for assessing the liability of fund advisers in "excessive fee" lawsuits brought under section 36(b) of the ICA.[44] Four years later, the *Jones* saga is not yet complete. The lawsuit still rests before the Seventh Circuit, for further consideration in light of the Supreme Court's ruling.[45]

Even as *Jones* remains in a curious state of limbo, new section 36(b) lawsuits continue to be initiated and pursued by the plaintiffs' bar. At the time this *Claims Trends* was published, fourteen section 36(b) lawsuits involving ten fund groups, by ICI Mutual's count, had been initiated since the Supreme Court's decision in *Jones*.[46] All but two of these post-*Jones* lawsuits remain pending.[47]

Meanwhile, two other section 36(b) lawsuits that were initiated *prior* to the Supreme Court's decision saw material developments in 2013.

NEW SECTION 36(B) LAWSUITS FILED IN 2013-14

Of the new section 36(b) lawsuits filed since the Supreme Court's decision in *Jones*, nine were filed in 2013 and early 2014. At the date this *Claims Trends* was published, eight of these lawsuits remain pending in federal district courts, and the ninth, following its dismissal by a federal district court, is on appeal before the Sixth Circuit.

Four of the nine section 36(b) lawsuits filed in 2013-2014 target "manager of managers" arrangements, focusing on alleged fee disparities between fees paid to the advisers (i.e., the "managers of managers") and the fees paid to unaffiliated subadvisers. Each of these four lawsuits remains in the early stages of litigation, with a motion to dismiss pending in one of them.[48]

A fifth of these nine new lawsuits targets the fees indirectly paid by investors in "funds-of-funds" (i.e., those mutual funds that invest solely in underlying mutual funds).[49] In this lawsuit, the plaintiff, an alleged shareholder in the funds-of-funds, challenges the level of fees (termed "acquired fund fees" in the complaint) paid to the adviser by the underlying funds (in which the plaintiff does *not* hold shares). In February 2014, this lawsuit was transferred to another federal district court,[50] which had previously considered the implication of the funds-of-funds structure in the context of a pre-*Jones* section 36(b) lawsuit (later dismissed by the parties) that was filed against the same defendant fund group.[51] The lawsuit remains pending.

Three more of these nine new section 36(b) lawsuits involve the same fund group, a common adviser, and, for two of the lawsuits, the same fund. As with the "manager of managers" lawsuits discussed above, these three cases also focus on alleged disparities between advisory fees and subadvisory fees. They differ from the other "manager of managers" lawsuits, however, in that (1) in one of the lawsuits, the focus is on alleged disparities between the fees charged by the advisers for

managing their *affiliated* fund and the lesser fees charged by one of the advisers in its role as a subadviser to *unaffiliated* funds;[52] and (2) in the second and third of these lawsuits, the focus is on alleged disparities between the fees charged by the adviser for managing an affiliated fund and the lesser fees charged by an *affiliated* subadviser to the same fund.[53] These cases remain in the early stages of litigation. Given that these cases involve the same fund group, a common adviser, and (in two cases) the same fund, it may be that they will be consolidated or otherwise coordinated as the litigation progresses.

The ninth of the section 36(b) lawsuits filed in 2013-2014 sought to challenge the "split" between the securities lending revenue paid to several exchange-traded funds (ETFs) and the revenue paid to the ETFs' adviser and its affiliate (which provided securities lending services). In October 2013, the court granted the defendants' motion to dismiss; the dismissal has been appealed to the Sixth Circuit.[54]

OTHER SECTION 36(B) LAWSUITS FILED POST-*JONES*

As of the date of this *Claims Trends,* three post-*Jones* lawsuits filed in 2010 and 2011 remain pending.

In one case, which focuses on alleged disparities between (1) the defendant's advisory fees and the fees paid to unaffiliated subadvisers, and (2) the advisory fees paid to the defendant by managed funds and the fees paid by the defendant's institutional accounts, the federal district court denied the defendant's motion to dismiss in December 2012.[55] In a second of these pending lawsuits, which also focuses on alleged disparities between the defendants' advisory fees and the fees paid to unaffiliated subadvisers, the court denied the defendants' motion to dismiss the plaintiffs' section 36(b) allegations in September 2012.[56] Both of these lawsuits are currently in the discovery (fact-finding) stage of the litigation process.

The third pending lawsuit, which targets a fund adviser, fund distributors, and certain affiliated insurance companies, combined section 36(b) claims and another ICA claim with ERISA claims.[57] In April 2012, the Third Circuit affirmed the lower court's dismissal of the ICA claims and remanded the lawsuit to the trial court for further proceedings.[58] The federal district court dismissed the ERISA claims in July 2013; the dismissal is on appeal to the Third Circuit.[59]

SECTION 36(B) LAWSUITS FILED PRE-*JONES*

As noted above, as of the date of this *Claims Trends*, two section 36(b) lawsuits that were initiated prior to *Jones* saw material developments in 2013. In one of these lawsuits, a federal district court in March 2013 refused to reconsider its earlier dismissal of the plaintiff's complaint. The dismissal is now pending before the Ninth Circuit.[60] In the second of these lawsuits, the parties reached an agreement to resolve the lawsuit in mid-2013, and the court approved the parties' voluntary dismissal with prejudice of the action.[61]

Other Developments in Fee Litigation

Outside the context of section 36(b), the plaintiffs' bar has also challenged fee payments under other legal theories involving different provisions of federal or state law. Prior *Claims Trends* reported on one such challenge in a lawsuit involving a financial institution's sale of its fund advisory business to another firm. The lawsuit charged the trustees of the affected funds with various violations of law in connection with their consideration of the sale and their approval of new advisory agreements, and

asserted, in essence, that the trustees "failed to avail themselves of the opportunity to negotiate lower fees or seek competing bids from other qualified investment advisors."[62]

As previously reported, the district court granted the defendants' motion for summary judgment in July 2012.[63] In November 2013, the Second Circuit affirmed the district court's dismissal and, in January 2014, denied the plaintiff's petition for rehearing.[64]

Disclosure

"Prospectus liability" lawsuits—i.e., shareholder class action lawsuits brought under the '33 Act—have proved over the years to be a major source of potential liability for funds and their directors, officers, advisers, and principal underwriters.[65]

No noteworthy new prospectus liability lawsuits were initiated against fund industry defendants in 2013 and early 2014. As discussed below, however, there were significant developments in prospectus liability lawsuits initiated during the subprime/credit crisis period and its aftermath.

Subprime/Credit Crisis Litigation

Prior *Claims Trends* have reported on '33 Act litigation filed against fund groups and other financial institutions in 2007-2009. Eight fund groups had one or more funds involved in major prospectus liability lawsuits (which, in some cases, also alleged non-'33 Act violations). These lawsuits challenged the adequacy of the disclosure provided by certain fixed-income funds that had significantly underperformed their peers during the subprime/credit crisis period.

Except in one instance, the courts ruled *against* fund group defendants at the motion-to-dismiss stage of these subprime/credit crisis lawsuits (i.e., the early, pre-trial stage at which defendants challenge the adequacy of plaintiffs' allegations on purely legal grounds).[66] The fund industry's claims experience evidences that prospectus liability lawsuits that survive motions to dismiss are likely to be settled, sooner or later, by agreement of the parties (with few, if any, ever reaching trial).

The subprime/credit crisis lawsuits have followed this pattern. By year-end 2012, settlements had been reached in subprime/credit crisis lawsuits involving six fund groups.[67] In 2013 and early 2014, final settlements were reached in two additional lawsuits, and a settlement was preliminarily approved in another.[68] Each of these settlements has involved multimillion dollar payments by the defendants, including two settlements with payments in the nine figures, and four with eight-figure payments. To date, total settlement amounts announced in these lawsuits are in excess of $550 million. Meanwhile, another prospectus liability lawsuit from the subprime/credit crisis period remains in progress and has yet to be finally resolved.[69]

Exchange-Traded and Inverse Funds

Previous *Claims Trends* reported on three prospectus liability class action lawsuits targeting leveraged exchange-traded funds (ETFs) and inverse funds. These lawsuits challenged the adequacy of prospectus disclosure relating to various attributes of the funds' investment strategies.

All three of these lawsuits have now reached final resolutions. A seven-figure settlement of one lawsuit was approved in early 2012;[70] in mid-2013, a federal

district court approved a seven-figure settlement of a second of these lawsuits.[71]

In the third case, involving leveraged ETFs, a federal district court granted the defendants' motion to dismiss in September 2012, and the plaintiffs appealed the dismissal to the Second Circuit. In July 2013, the Second Circuit affirmed the dismissal, concluding that the ETFs' prospectuses "made clear that leveraging, compounding, volatility, and aggressive investment techniques subject the ETFs to high degrees of risk" and that it was "implausible that a reasonable investor would read [the] offering documents without understanding the potential for rapid, substantial loss."[72]

The Second Circuit decision demonstrates that not every prospectus liability lawsuit must necessarily end in a settlement. Here, the fund group achieved a complete victory, successfully defending the adequacy of its disclosure at both the federal district court and appellate court levels. The decision underscores the importance to fund groups of implementing strong practices and procedures to promote complete and accurate fund disclosure, and the litigation benefits that can accrue from such efforts.

Other Disclosure-Based Litigation

Over the years, fund shareholders have sometimes sought to challenge disclosure in "securities fraud" class action lawsuits brought under section 10(b) of the '34 Act and rule 10b-5 thereunder. Shareholders filing class action lawsuits under rule 10b-5 are subject to various legal requirements that can be difficult to satisfy in the mutual fund context, including the requirement to demonstrate that defendants engaged in intentional or reckless misconduct (i.e., "scienter"). As a result, fund industry defendants have historically enjoyed considerable success in defending against these lawsuits.

Prior *Claims Trends* have reported on the U.S. Supreme Court's 2011 decision in Janus Capital Group v. First Derivative Traders, in which the Court held that an investment adviser to mutual funds did not itself "make" any of the alleged misstatements in the fund prospectus, and therefore could not be liable as a "primary" violator in shareholder litigation brought under rule 10b-5.[73]

Outside the registered fund space, the *Janus* decision continues to be interpreted by lower federal courts.[74] Within the registered fund space, *Janus* has had limited impact, although the decision did figure in a long-running rule 10b-5 lawsuit (originally filed in 2005) that alleged that a fund adviser made false and misleading statements regarding a contract for transfer agency services for its managed funds. In August 2012, the court, citing *Janus*, dismissed the rule 10b-5 claims against the investment adviser defendants, but rejected efforts by an individual defendant (an officer of the adviser and principal accounting officer for many of the funds) to rely on *Janus*, as the individual defendant had signed the disclosure documents (and could therefore be viewed as having "made" the statements in those documents).[75]

In October 2013, seven months after the district court granted class certification in the lawsuit, the court preliminarily approved a settlement among the plaintiffs, the individual defendant, and the previously dismissed investment adviser defendants.[76]

Another rule 10b-5 lawsuit currently before the U.S. Supreme Court, Halliburton Co. v. Erica P. John

Fund, Inc., does not involve fund group defendants, but has engendered considerable discussion in the broader financial institutions area. In *Halliburton*, the Court is expected to consider the continued viability of a long-standing legal doctrine known as the "fraud on the market" theory[77]—a theory that has been, in the words of one commentator, "the foundation of [a] megabillion-dollar securities class action industry" for the plaintiffs' bar.[78] The Court's decision is expected this June. Because rule 10b-5 class actions are infrequent in the registered fund space, and because the "fraud on the market" theory is not generally applicable in the mutual fund context, it appears unlikely that the Court's decision will have a significant impact on fund shareholder litigation.

Portfolio Management Errors

Since ICI Mutual's formation in 1987, approximately 10% of all claim amounts paid by ICI Mutual have been for "costs of correction" claims—i.e., insurance claims by advisers for payments made by them, outside the litigation context, to remedy operational errors that have resulted in losses for their managed funds or private accounts. Generally, "costs of correction" insurance coverage permits an insured adviser (or other insured service provider) to be reimbursed for costs incurred to correct an operational error, provided that the adviser or other service provider has actual legal liability for the resulting loss.[79]

One recent such claim involved the inadvertent sale of a security in connection with an adviser's rebalancing of the portfolios of multiple accounts to reflect changes in the composition of a model portfolio. The inadvertent sale of the security in question was not flagged in the adviser's post-trade review of relevant reports. As with some past "costs of correction" claims, this claim highlighted the presence of vulnerabilities in even robust compliance systems designed to prevent and detect trading errors.[80]

State Law Actions and the Plaintiffs' Bar

Litigation challenges to fund groups sometimes take the form of (i) *state law derivative actions*—i.e., lawsuits filed ostensibly on behalf of funds themselves, that allege violations of state or common law by fund advisers and/or fund directors and officers, or (ii) *state law class actions*—i.e., lawsuits filed ostensibly on behalf of groups (or "classes") of fund shareholders, that allege violations of state or common law by fund advisers, funds themselves, and/or fund directors and officers.[81]

This section describes developments in state law derivative actions and class actions in 2013 and early 2014.

Fund Investments in Gambling Industry Securities

Past *Claims Trends* have reported on federal lawsuits first filed in 2008 against various fund groups, which

originally alleged that fund investments in online gambling companies constituted illegal racketeering in violation of RICO. While most of these federal lawsuits were dismissed by the courts,[82] various plaintiffs subsequently refiled (or re-refiled) their lawsuits in either federal or state courts. The refiled lawsuits, based on essentially the same activities, were recharacterized as derivative actions and chiefly alleged violations of state law or common law (e.g., breach of fiduciary duty and waste).

The long and tortuous procedural history of one of these "gambling security" lawsuits demonstrates how difficult it can sometimes be for defendants to bring a derivative lawsuit to conclusion. During the period 2009 to 2012, the plaintiff's original lawsuit (filed in federal court) was voluntarily dismissed by the plaintiff, refiled by the plaintiff in state court, removed by the defendants to federal court, dismissed by the federal court on procedural grounds, refiled in another federal court, and transferred back to the original federal court, where it was dismissed in June 2012.[83]

The plaintiff then filed another amended complaint in federal court, which was dismissed without prejudice in March 2013.[84] The plaintiff appealed this dismissal to the Second Circuit. In October 2013, the Second Circuit affirmed in part and vacated in part the district court's decision; in November 2013, the district court dismissed with prejudice the remaining claims in the lawsuit.[85]

Meanwhile, gambling security lawsuits continue for three other fund groups. For one fund group, the dismissal of a refiled lawsuit was affirmed by a state supreme court in January 2012.[86] More than a year later, in June 2013, the plaintiffs filed yet another complaint in federal court in Delaware, where the lawsuit remains pending.[87]

For another fund group, the original lawsuit was dismissed by a federal district court in February 2012 (with the dismissal thereafter affirmed on appeal by the Eighth Circuit in March 2013). After making demand on the fund board, the plaintiff then refiled his lawsuit in federal district court in March 2014.[88]

Meanwhile, this same fund group also has another active lawsuit, in which the district court denied the defendants' motion to dismiss in October 2012, ruling that the plaintiffs could "conduct limited discovery into whether the [special litigation committee that had reviewed the plaintiff's demand] was independent, acted in good faith, and followed reasonable procedures."[89] That lawsuit remains in the discovery phase. A motion for summary judgment is expected to be filed.

A third fund group's gambling security lawsuit, which had been refiled in state court, was dismissed in November 2013, and a notice of appeal was filed in March 2014.[90]

Auction-Rate Preferred Securities

Previous *Claims Trends* have reported on lawsuits involving closed-end funds that issued auction-rate preferred securities (ARPS). A number of these lawsuits, filed as derivative lawsuits, effectively charged breach of fiduciary duties to common shareholders through the defendants' authorizing or participating in the redemption of ARPS in favor of new financing that was allegedly less favorable to the common shareholders. These cases are slowly being resolved, with two of these derivative lawsuits being concluded in 2013 in favor of the defendants.[91] Two additional derivative lawsuits remain pending.[92]

Shareholder Derivative Suits Generally

As described in the previous two subsections, the plaintiffs' bar has brought a number of derivative lawsuits in recent years. Derivative lawsuits in the fund industry typically allege that fund advisers or their affiliates, and/or fund officers or directors, have breached their fiduciary duties or otherwise engaged in violations of law with respect to their funds.

Before initiating derivative lawsuits, fund shareholders generally must first make "demands" on the fund boards asking the boards to authorize and pursue litigation on behalf of the funds. Shareholders failing to make such demands often find their lawsuits dismissed by the courts as a matter of law.[93]

Courts may, however, excuse fund shareholders from the "demand" requirement under certain circumstances. One such circumstance, sometimes referred to as "demand futility," was explored in a decision by the First Circuit in early 2013. There, the appellate court ruled that a majority of fund directors in question were not sufficiently independent and disinterested to impartially consider the shareholder demands. The appellate court conducted a *de novo* review of the facts and concluded that the shareholders were excused from meeting the demand requirement. The U.S. Supreme Court agreed in June 2013 to hear the question of the appellate court's *de novo* review of demand futility. However, because the plaintiffs had sold their shares of the funds in question, they lacked standing to pursue their claim, and the case was dismissed in August 2013.[94]

Where shareholders have made demands on fund boards to authorize and pursue litigation, the boards often respond by appointing special committees of independent directors to conduct "shareholder derivative demand investigations" (SDDIs) of the relevant facts and law. These SDDIs are intended to assist boards (or their special committees) in making informed decisions as to whether or not the authorization and pursuit of litigation are in the best interests of their funds.

After SDDIs, fund boards may, and often do, determine not to pursue litigation. In such cases, the plaintiffs' bar may challenge the boards' determinations in court. In evaluating these challenges, courts typically consider whether the boards acted independently, in good faith, and following reasonable inquiry.

Courts may closely examine the process by which fund boards consider and respond to demands. In one of these decisions, discussed above at pages 7-8, a federal district court concluded that there was no genuine factual dispute regarding the independence of fund directors or their good faith and reasonableness in investigating and rejecting a shareholder demand. The judge granted summary judgment in favor of the defendants.[95] As noted, the Second Circuit affirmed the district court's dismissal in November 2013 and subsequently denied the plaintiff's petition for rehearing.[96]

In a March 2013 decision in another long-running derivative lawsuit (discussed above at page 11), the court dismissed the lawsuit following a review of the plaintiff's challenge to a decision of a committee of a fund board that had conducted a SDDI prior to rejecting the plaintiff's demand. The court concluded that the plaintiff's allegations failed "to rise to the level of specificity required to overcome the strong deference owed to a board under the business judgment rule."[97] The plaintiff appealed the court's decision to the Second Circuit, which

affirmed in part and vacated in part, remanding the case back to the district court. Finally, in November of 2013, the district court dismissed the remaining claims with prejudice.[98]

Other Litigation Developments

ERISA

Fund advisers and affiliated entities may face allegations under ERISA that are similar to those made outside the ERISA context. As described below, several recent lawsuits have challenged fees and compensation received by plan service providers, and other lawsuits have alleged that plan "fiduciaries" mismanaged assets under their control.

FEE-BASED LAWSUITS

As described in recent *Claims Trends*, the plaintiffs' bar has long mounted securities law challenges to the fees and compensation received by fund advisers and their affiliates. In recent years, the plaintiffs' bar has also initiated numerous fiduciary lawsuits under ERISA challenging fees and compensation received directly or indirectly by plan service providers.

2013 and early 2014 saw developments in certain fee-based ERISA lawsuits filed in recent years. As discussed above (at page 7), in a 2011 lawsuit alleging excessive fee claims under both ERISA and section 36(b), the trial court dismissed the ERISA claims (the only remaining claims) in July 2013. The dismissal is now on appeal to the Third Circuit.[99]

As previously reported, two fund group defendants—one, the directed trustee and recordkeeper for ERISA plans, and the other, an investment adviser for the mutual funds offered as investment options—were involved in an ERISA lawsuit in which the plaintiffs made fee-based allegations. In March 2012, the federal district court found, among other things, that the fund group defendants were ERISA "fiduciaries" (but not with respect to excessive fees) and that they breached their fiduciary duties to the plan with respect to the handling of "float income."[100]

In March 2014, the Eighth Circuit vacated the federal district court's decision, ruling that, because the plaintiffs failed to demonstrate that the float income was a plan asset, the district court had erred in finding that the fund group defendants had breached their fiduciary duties.[101] The case has been remanded for proceedings consistent with the appellate court's decision.[102]

Meanwhile, in early 2013, perhaps encouraged by the district court's ruling in the case discussed above, a number of plaintiffs brought similar allegations in another federal district court against entities in the same fund group for the treatment of float income. In December 2013, four of the cases were consolidated, and a motion to dismiss remains pending.[103] The future of this consolidated litigation is uncertain, however, given the Eighth Circuit's decision in the case discussed above.

Entities in the same fund group have also been named in other recent ERISA lawsuits in which the plaintiffs alleged that the defendants breached their fiduciary duties with respect to sponsoring and/or administering their own retirement plan. One of these lawsuits, filed in March 2013, charges that the plan's sponsor made available to the plan only high-cost proprietary mutual funds when other, lower-

cost options should allegedly have been provided.[104] In another lawsuit, filed in early 2014, the plaintiffs allege the sponsor's negotiation of recordkeeping arrangements benefited the sponsor to the detriment of the plan participants.[105] Each of these lawsuits is in its early stages and remains pending.

Several other recent ERISA cases seem to mirror the fee challenges in some of the section 36(b) lawsuits, but allege violations of ERISA rather than of section 36(b). A motion to dismiss is pending in one of these lawsuits (filed in November 2013).[106] A second lawsuit, filed in March 2014, alleges that the provider of retirement account services charged excessive fees through the structure of its retirement products.[107] This lawsuit is in its early stages and remains pending.

MISMANAGEMENT LAWSUITS

The federal securities laws do not generally permit direct actions against advisers for alleged mismanagement of assets. By contrast, ERISA expressly provides for direct suits against plan "fiduciaries" for mismanagement of assets under their control—i.e., for failure to adhere to their duty of "prudent management." While mutual fund advisers are generally exempt from ERISA claims of imprudent management, advisers to unregistered pooled investment vehicles that contain plan assets may be subject to such claims.

Advisers under ERISA may face significant liability risks. As reported in prior *Claims Trends*, in a lawsuit involving an investment adviser to certain unregistered funds that sustained significant losses during the subprime/credit crisis period, a federal district court ruled that the adviser violated certain fiduciary duties under ERISA and ordered the adviser to pay eight-figure damages.[108] The lawsuit was resolved by agreement of the parties and dismissed in its entirety in January 2013.[109]

In an ERISA lawsuit filed in 2010, the plaintiffs alleged that the investment adviser to the ERISA plans breached its fiduciary duty through its management of a securities lending program that allegedly resulted in losses and restricted investment liquidity.[110] The trial court preliminarily approved a plan of settlement in January 2014.[111]

Bankruptcy Claims by Issuers of Portfolio Securities

Mutual funds have occasionally been ensnared in proceedings arising from corporate bankruptcies, typically for no reason other than the funds' status as passive holders or former holders of securities of the bankrupt issuers. In these proceedings, sometimes referred to as "clawback" suits, bankrupt issuers and/or their creditors often seek a return of pre-bankruptcy payments made to security holders or other creditors, including funds.

As reported in prior *Claims Trends,* recent proceedings (including proceedings arising out of the bankruptcies of the Tribune Company and the Lyondell Chemical Company) have named numerous funds as parties.[112] The Tribune and Lyondell proceedings raise a number of legal issues, including issues regarding the legal right (or "standing") of the plaintiffs to prosecute their claims, the timeliness of the plaintiffs' claims, and the applicability to the plaintiffs' claims of a "safe harbor" defense in the federal bankruptcy code for "settlement payments."

Both the Lyondell and Tribune proceedings involve state law "constructive fraudulent conveyance" and "intentional fraudulent conveyance" claims. In September 2013, a federal district court in Tribune granted the defendants' motions to dismiss the

constructive fraudulent conveyance claims, but left open the possibility that plaintiffs could re-file the claims at a later date.[113] The district court's decision is on appeal to the Second Circuit, with oral argument scheduled for May 2014.[114]

In Lyondell, the bankruptcy court in January 2014 denied the defendants' motion to dismiss the state law constructive fraudulent conveyance claims. The court granted the defendants' motion to dismiss the state law intentional fraudulent conveyance claims, but gave the plaintiffs permission to replead these claims to correct their deficiencies.[115]

Whistleblower Lawsuits

In March 2014, the U.S. Supreme Court ruled that anti-retaliation protections for whistleblowers established under Sarbanes-Oxley extend to employees of privately held contractors (e.g., privately held fund advisers) that render services to public companies (e.g., mutual funds).[116]

The underlying lawsuits were filed in 2008 by two former employees of a privately held fund adviser, who alleged that they had raised concerns, respectively, about the profitability analyses conducted by the adviser and about purportedly material inaccuracies and omissions in fund disclosure with respect to the compensation of portfolio managers. Both plaintiffs claimed that their employment was thereafter unlawfully and wrongfully terminated in violation of provisions of Sarbanes-Oxley and state law.

In March 2010, the federal district court denied the adviser's motions to dismiss with respect to the plaintiffs' federal law claims under Sarbanes-Oxley, but granted the motions to dismiss with respect to the plaintiffs' state law claims.[117] In February 2012, the First Circuit reversed the district court's decision. Thereafter, as noted above, the U.S. Supreme Court reversed the First Circuit's decision. The case has been remanded for further proceedings.

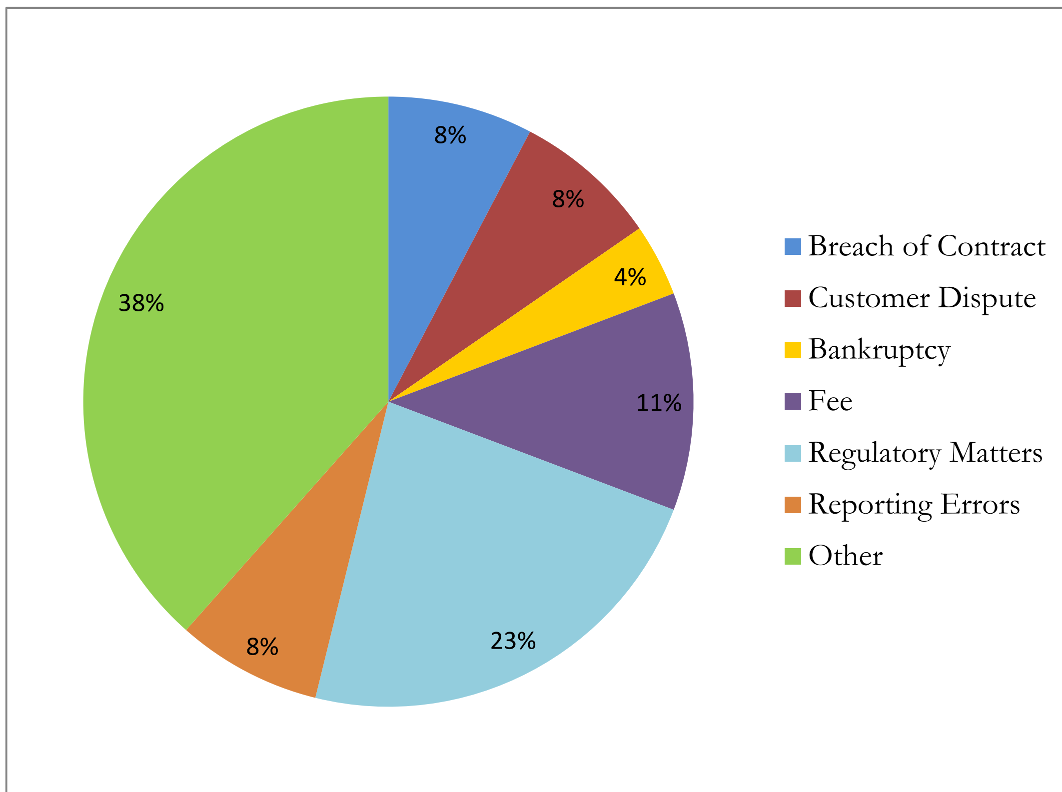
Some observers have suggested that the Court's decision may lead to increased litigation and/or regulatory proceedings, both inside and outside the fund industry, initiated by whistleblowers themselves or by private litigants and/or regulators acting on the basis of information disclosed by whistleblowers.[118]

D&O/E&O Claims Data

D&O/E&O Notices – 2013

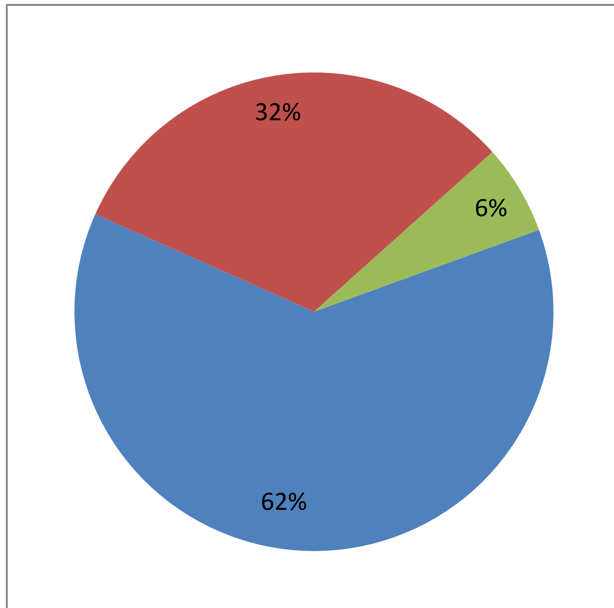
The most common subject matters in claims notices provided under ICI Mutual D&O/E&O policies in 2013 included (1) regulatory matters and (2) fee litigation. As shown in the chart below, a substantial percentage of notices received (the "Other" category) do not fall neatly into a broader category.

D&O/E&O Notices by Subject (2013)



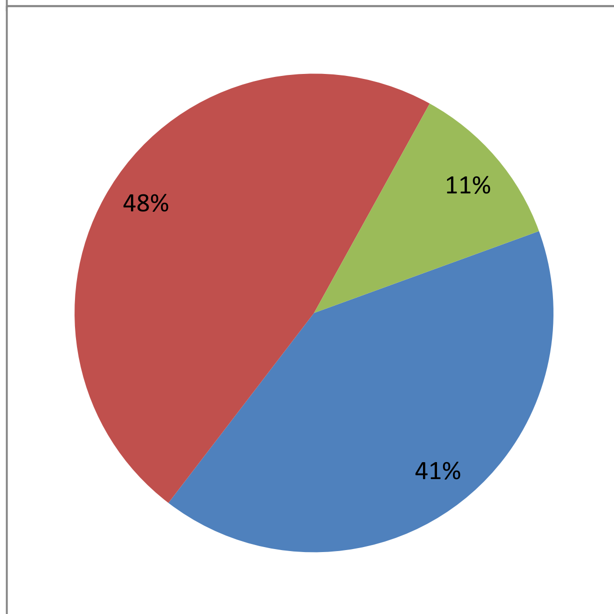
D&O/E&O Insurance Payments by Category (2000-2013)

The first chart below shows the breakdown of payments (i.e., defense costs, settlements and judgments, and costs of correction) made by ICI Mutual on claims submitted from January 1, 2000 through December 31, 2013 under ICI Mutual D&O/E&O policies. The second chart shows the same information, but *excludes* payments made on insurance claims associated with the mutual fund trading scandal of 2003-2004.



(2000-2013, *including* scandal-related claims)

Defense Costs
Settlements & Judgments
Costs of Correction



(2000-2013, *excluding* scandal-related claims)

Endnotes

[1] *See* SEC Biography: Chair Mary Jo White, http://www.sec.gov/about/commissioner/white.htm.

[2] *See* Mary Jo White, Chair, SEC, Remarks at the Securities Enforcement Forum (Oct. 9, 2013), http://www.sec.gov/News/Speech/Detail/Speech/1370539872100. Invoking the approach taken in New York City in the 1990s by the mayor and the police department, Chair White stated that "the smallest infractions are very often just the first step toward bigger ones down the road." To that end, she indicated that the SEC would enforce any and all of its rules, to "avoid an environment of disorder that would encourage more serious crimes to flourish." *Id.*

[3] *See, e.g.*, Mary Jo White, Chair, SEC, Perspectives on Strengthening Enforcement, Remarks via videoconference to the Annual Forum of the Australian Securities and Investments Commission (Mar. 24, 2014), http://www.sec.gov/News/Speech/Detail/Speech/1370541253621; Kara M. Stein, Commissioner, SEC, Remarks at the American Bar Association Business Law Section's Federal Regulation of Securities Committee Fall Meeting (Nov. 22, 2013), http://www.sec.gov/News/Speech/Detail/Speech/1370540403898; Luis A. Aguilar, Commissioner, SEC, A Stronger Enforcement Program to Enhance Investor Protection (Oct. 25, 2013), http://www.sec.gov/News/Speech/Detail/Speech/1370540071677. In October 2013, the SEC's then co-director of the Division of Enforcement articulated the goal of bringing the "swagger" back to the SEC. *See* Alison Frankel, *SEC Enforcement co-director: We're bringing 'swagger' back*, REUTERS (Oct. 1, 2013), http://blogs.reuters.com/alison-frankel/2013/10/01/sec-enforcement-co-director-were-bringingswagger-back/.

[4] *See* SEC, *Year-by-Year SEC Enforcement Statistics* (Dec. 17, 2013), http://www.sec.gov/news/newsroom/images/enfstats.pdf.

[5] While relatively uncommon, there have been SEC enforcement actions brought against fund independent directors in the past. *See, e.g.*, In re The Rockies Fund, Inc., Admin. Proc. No. 3-9615, ICA Rel. No. 27593 (Dec. 7, 2006), *available at* https://www.sec.gov/litigation/opinions/2006/34-54892.pdf (in SEC action involving a business development company, two independent directors received cease and desist orders, prohibitions on associating with investment companies for a period of three years, and civil monetary penalties of $20,000 each); In the Matter of Jon D. Hammes, Admin. Proc. No. 3-11351, ICA Rel. No. 26290 (Dec. 11, 2003), *available at* https://www.sec.gov/litigation/admin/33-8346.htm (independent directors of an investment company consented to an SEC order requiring them to cease and desist from committing or causing certain violations of the '33 Act and the ICA; no civil monetary penalties involved); In the Matter of Parnassus Investments, Admin. Proc. No. 3-9317, Init. Decisions Rel. No. 131 (Sept. 3, 1998), '34 Act Rel. No. 40534 (Oct. 8, 1998), *available at* https://www.sec.gov/litigation/aljdec/1998/34-40534.pdf (in SEC action involving an open-end fund, two independent directors received cease and desist orders, but no civil monetary penalties).

[6] *See* In re Navigator Money Mgmt., Inc., Admin. Proc. No. 3-15707, ICA Rel. No. 30897 (SEC Jan. 30, 2014), *available at* http://www.sec.gov/litigation/admin/2014/33-9521.pdf (SEC found that investment adviser and its president, majority owner, and chief compliance officer issued misleading advertisements regarding, among other things, the performance of a mutual fund managed by the adviser.); In re Northern Lights Compliance Svcs., Admin. Proc. No. 3-15313, ICA Rel. No. 30502 (SEC May 2, 2013), *available at* https://www.sec.gov/litigation/admin/2013/ic-30502.pdf (SEC found that certain fund shareholder reports contained "boilerplate disclosures" that were materially untrue or misleading regarding the factors taken into consideration by the board in approving advisory contracts.).

[7] *See* In re Chariot Advisors, LLC, Admin. Proc. No. 3-15433, ICA Rel. No. 30655 (SEC filed Aug. 21, 2013), *available at* http://www.sec.gov/litigation/admin/2013/34-70239.pdf (SEC instituted proceedings alleging that, in connection with a mutual fund's board evaluation and approval of the fund's advisory agreement, the investment adviser misrepresented its ability to implement the proposed investment strategy and misled the board about the nature, extent, and quality of services it could provide.).

[8] *See* In re Ambassador Capital Mgmt., LLC, Admin. Proc. No. 3-15625, ICA Rel. No. 30809 (SEC filed Nov. 26, 2013), *available at* https://www.sec.gov/litigation/admin/2013/ia-3725.pdf (SEC instituted proceedings against

fund adviser alleging, among other things, that it made false statements to the board of a money market fund regarding the level of risk in the fund's portfolio.).

[9] *See* In the Matter of Western Asset Mgmt. Co., Admin. Proc. No. 3-15688, ICA Rel. No. 30893 (SEC Jan. 27, 2014), *available at* http://www.sec.gov/litigation/admin/2014/ia-3762.pdf (SEC found that investment adviser engaged in cross trading violations with respect to the accounts of mutual fund and other advisory clients.).

[10] *See* In the Matter of Western Asset Mgmt. Co., Admin. Proc. No. 3-15689, IAA Rel. No. 3763 (SEC Jan. 27, 2014), *available at* http://www.sec.gov/litigation/admin/2014/ia-3763.pdf (SEC found that investment adviser failed to disclose violations of an issuer-imposed investment restriction to its advisory clients.).

[11] *See* In re Manarin Inv. Counsel, Ltd., Admin. Proc. No. 3-15549, ICA Rel. No. 30740 (SEC Oct. 2, 2013), *available at* http://www.sec.gov/litigation/admin/2013/33-9462.pdf (SEC found that investment adviser breached its fiduciary duty to three advisory clients by causing them to purchase higher-fee share classes of mutual funds.).

[12] *See* In re Oppenheimer Asset Mgmt. Inc., Admin. Proc. No. 3-15238, IAA Rel. No. 3566 (SEC Mar. 11, 2013), *available at* https://www.sec.gov/litigation/admin/2013/33-9390.pdf (SEC found that investment adviser misrepresented the value of a private fund to investors and prospective investors.).

[13] *See* In re Sandeep Goyal, Admin. Proc. No. 3-15323, IAA Rel. No. 3607 (SEC May 9, 2013), *available at* https://www.sec.gov/litigation/admin/2013/ia-3607.pdf (SEC found that research analyst employed by investment adviser traded securities on the basis of material nonpublic information.).

[14] *See* In re Johns, Admin. Proc. No. 3-15440, ICA Rel. No. 30675 (SEC Aug. 27, 2013), *available at* https://www.sec.gov/litigation/admin/2013/ia-3655.pdf (SEC found that assistant portfolio manager of closed-end fund adviser executed personal securities transactions in violation of code of ethics restrictions.).

[15] *See* In re Northern Lights Compliance Svcs., *supra* note 6.

[16] In separate administrative proceedings involving one of the aforementioned series trusts, the SEC found that, during the contract approval process, an adviser to one of the series misrepresented to the board its ability to execute the proposed investment strategy. *See* In re Chariot Advisors, LLC, *supra* note 7.

[17] *See* In re J. Kenneth Alderman, Admin. Proc. No. 3-15127, ICA Rel. No. 30557 (SEC June 13, 2013), *available at* https://www.sec.gov/litigation/admin/2013/ic-30557.pdf (SEC found, among other things, that mutual fund board: (1) had not specified a fair valuation methodology to be used; (2) did not "continuously review the appropriateness of the method to be used" in valuing each portfolio security; (3) did not provide "any meaningful substantive guidance" to the valuation committee on how fair valuation determinations should be made; and (4) "did not learn how fair values were actually being determined.").

[18] *See, e.g.*, Beagan Wilcox Volz, *Lessons from the SEC's Northern Lights, Gemini Case,* IGNITES (May 3, 2013), http://www.ignites.com/c/514041/57181 (noting, among other things, the SEC's focus on "boilerplate" disclosure); *Morgan Keegan Case Spurs Valuation Soul Searching*, IGNITES (Mar. 28, 2013), http://www.ignites.com/c/495621/55431 (reporting that the SEC action has prompted "numerous firms in the weeks and months following the December enforcement action [to seek] an external assessment or reassessment of their valuation policies and procedures"); *SEC Brings Enforcement Action Against Mutual Fund Directors For Alleged Failures in Oversight of Valuation Committee*, Ropes & Gray Alert, Dec. 13, 2012, http://www.ropesgray.com/~/media/Files/alerts/2012/12/sec-brings-enforcement-action-against-mutual-fund-directors-for-alleged-failures-in-oversight-of-valuation-committee.ashx (noting the difficulties faced by fund directors in complying with fair valuation guidance "when overseeing complex funds that utilize a wide range of investment instruments amidst challenging market conditions"; and commenting on the SEC enforcement staff's views regarding the role of directors in valuation).

[19] *See, e.g.*, Peter Rawlings, *SEC Officials: Fund Boards Are Not Targets*, FUND DIRECTOR INTELLIGENCE (Mar. 13, 2014), http://www.funddirectorintelligence.com/Article/3319378/Default/SEC-Officials-Fund-Boards-Are-Not-Targets.html; Hillary Jackson, *SEC: Targeting Boards 'Relatively Unusual'*, FUND DIRECTOR INTELLIGENCE

(Apr. 11, 2013), http://www.funddirectorintelligence.com/Article/3190033/Search/SEC-Targeting-Boards-Relatively-Unusual.html. Recognizing that an enforcement focus on individuals might deter qualified individuals from serving as directors, Chair White suggested that the SEC was unlikely to pursue fund directors who "appropriately perform their duties." Mary Jo White, Remarks at the Securities Enforcement Forum (Oct. 9, 2013), *supra* note 2.

[20] *See, e.g.*, Mary Jo White, Remarks at the Securities Enforcement Forum (Oct. 9, 2013), *supra* note 2; Mary Jo White, Chair, SEC, Chairman's Address at SEC Speaks 2014 (Feb. 21, 2014), http://www.sec.gov/News/Speech/Detail/Speech/1370540822127; Mary Jo White, Chair, SEC, The SEC in 2014, Remarks at the 41st Annual Securities Regulation Institute (Jan. 27, 2014), http://www.sec.gov/News/Speech/Detail/Speech/1370540677500; Kara M. Stein, Remarks at the American Bar Association Business Law Section's Federal Regulation of Securities Committee Fall Meeting (Nov. 22, 2013), *supra* note 3.

[21] SEC v. Reserve Mgmt. Co., No. 1:09-cv-4346 (S.D.N.Y. Nov. 13, 2012) (jury verdict form).

[22] SEC v. Reserve Mgmt. Co., 2013 U.S. Dist. LEXIS 141018 (S.D.N.Y. Sept. 30, 2013).

[23] SEC v. Reserve Mgmt. Co., 2013 U.S. Dist. LEXIS 141018 (S.D.N.Y. Jan. 21, 2014).

[24] In re Heartland Advisors, Inc., Admin. Proc. No. 3-12936, ICA Rel. No. 28136 (SEC Jan. 25, 2008) (settlement with SEC), *available at* http://www.sec.gov/litigation/admin/2008/33-8884.pdf; SEC v. Heartland Advisors, Inc., No. 2:03-cv-1427 (E.D. Wis. Feb. 21, 2008) (stipulation of dismissal).

[25] SEC v. Bauer, 2011 U.S. Dist. LEXIS 56780 (E.D. Wis. May 25, 2011).

[26] The Seventh Circuit observed that no federal court had directly considered the issue, and that the SEC had not previously tested the issue in the mutual fund context. SEC v. Bauer, 723 F.3d 758, 769 (7th Cir. 2013).

[27] SEC v. Heartland Advisors, Inc., No. 2:03-cv-1427 (E.D. Wis. filed Dec. 11, 2003).

[28] *See* Robert Khuzami, Director, Division of Enforcement, SEC, Testimony on "Examining the Settlement Practices of U.S. Financial Regulators" Before the Committee on Financial Services, U.S. House of Representatives (May 17, 2012), https://www.sec.gov/news/testimony/2012/ts051712rk.htm.

[29] *See* Joe Harris, *SEC to Start Demanding Wrongdoing Admissions*, IGNITES (June 19, 2013), http://www.ignites.com/c/537841/60121. The change in policy follows a prior modification to the policy announced in January 2012. At that time, the Director of the SEC's Enforcement Division announced that the SEC was modifying its approach to "neither admit nor deny" settlements, so that a defendant in a civil proceeding could not use the "neither admit nor deny" formulation if there were a parallel criminal investigation or proceeding. *See* Robert Khuzami, Director, Division of Enforcement, SEC, Public Statement by SEC Staff: Recent Policy Change (Jan. 7, 2012), https://www.sec.gov/news/speech/2012/spch010712rsk.htm; 17 C.F.R. § 202.5(e) (2012).

[30] These included settlements with a hedge fund manager who manipulated bond markets, with a large investment bank for the actions of a rogue trader, and with three brokerage subsidiaries for misleading customers with respect to trading fees. *See* Press Release, SEC, Philip Falcone and Harbinger Capital Agree to Settlement (Aug. 19, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539780222 (SEC's Enforcement Division's initial settlement with Falcone was rejected by the SEC, who insisted upon an admission of wrongdoing; *see* SEC v. Falcone, 2013 U.S. Dist. LEXIS 132300 (S.D.N.Y. Sept. 16, 2013)); Press Release, SEC, JPMorgan Chase Agrees to Pay $200 Million and Admits Wrongdoing to Settle SEC Charges (Sept. 19, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539819965; In the Matter of JPMorgan Chase & Co., Admin. Proc. No. 3-15507, '34 Act Rel. 70458 (SEC Sept. 19. 2013), *available at* http://www.sec.gov/litigation/admin/2013/34-70458.pdf; Press Release, SEC, SEC Charges ConvergEx Subsidiaries With Fraud for Deceiving Customers About Commissions (Dec. 18, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540521484; In the Matter of G-Trade Services LLC, ConvergEx Global Markets Limited, Admin. Proc. No. 3-15654, IAA Rel. No. 3744 (SEC Dec. 18, 2013), *available at* http://www.sec.gov/litigation/admin/2013/34-71128.pdf; In the Matter of Jonathan Samuel Daspin, Admin. Proc. No. 3-15652, ICA Rel. No. 30838 (SEC Dec. 18, 2013), *available at* http://www.sec.gov/litigation/admin/

2013/34-71126.pdf; In the Matter of Thomas Lekargeren, Admin. Proc. No. 3-15653 (SEC Dec. 18, 2013), *available at* http://www.sec.gov/litigation/admin/2013/34-71127.pdf.

[31] *See, e.g.*, Mary Jo White, Chair, SEC, The SEC in 2014, Remarks at the 41st Annual Securities Regulation Institute, Jan. 27, 2014, *supra* note 20; Mary Jo White, Chair, SEC, The Importance of Independence, 14th Annual A.A. Sommer, Jr. Corporate Securities and Financial Law Lecture, Fordham Law School, Oct. 3, 2013, *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370539864016#.Uk6PpySsiSo.

[32] *See* SEC, ANNUAL REPORT ON THE DODD-FRANK WHISTLEBLOWER PROGRAM: FISCAL YEAR 2013 (2013), http://www.sec.gov/about/offices/owb/annual-report-2013.pdf [hereinafter SEC WHISTLEBLOWER REPORT].

[33] *See* Press Release, SEC, SEC Awards More Than $14 Million to Whistleblower(Oct. 1, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539854258.

[34] *See* SEC WHISTLEBLOWER REPORT, *supra* note 32; Bruce Carton, *Details on the Case Underlying the SEC's $14 Million Whistleblower Award*, COMPLIANCE WEEK (Feb. 27, 2014), *available at* http://www.complianceweek.com/details-on-the-case-underlying-the-secs-14-million-whistleblower-award/article/336015/.

[35] *See, e.g.*, Larry Locke, *Three Areas the SEC Needs to Improve in 2014*, IGNITES (Jan. 8, 2014), http://www.ignites.com/c/632394/71624 (suggesting that the SEC's whistleblower program permits it to "outsource some of its investigative functions effectively," particularly with respect to the fund industry).

[36] Press Release, SEC, SEC Announces First Deferred Prosecution Agreement With Individual (Nov. 12, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540345373. An SEC official observed that "the DPA holds [the individual] accountable for his misconduct but gives him significant credit for reporting the fraud and providing full cooperation without any assurances of leniency." *Id.*

[37] Gabelli v. SEC, 133 S. Ct. 1216 (2013).

[38] In another case, SEC v. Bartek, 484 Fed. Appx. 949 (5th Cir. Aug. 7, 2012), the Fifth Circuit ruled that the SEC actions seeking injunctions or officer-and-director bars are also subject to the same limitations period that was at issue in *Gabelli*. The SEC filed a petition for a writ of certiorari with the U.S. Supreme Court, but, shortly after the issuance of the *Gabelli* decision, the SEC moved to dismiss its petition, and the Court granted the SEC's motion.

[39] *See, e.g.*, Brant Phillips and Britt Latham, *Supreme Court* Gabelli *decision will continue to bring changes to SEC enforcement policy*, INSIDE COUNSEL, Feb. 26, 2014, http://www.insidecounsel.com/2014/02/26/supreme-court-igabelli-i-decision-will-continue-to; Gabelli v. SEC*: The Supreme Court Limits the Statue of Limitations for SEC Actions*, Cozen O'Connor Client Alert, Mar. 20, 2013, http://www.cozen.com/cozendocs/Outgoing/alerts/2013/GIG_Liability_032013.pdf; Gabelli: *The Supreme Court Rejects the SEC's Reliance on the "Discovery Rule" in Civil Penalty Actions*, Fried Frank Client Alert, Mar. 6, 2013, http://www.friedfrank.com/siteFiles/Publications/FINAL_3-6-2013_TOC_Memo_Gabelli_The_Supreme_Court_Rejects_the_SECs_Reliance_on_the_Discovery_Rule_in_Civil_Penalty_Actions.pdf.

[40] *See, e.g.*, Brant Phillips and Britt Latham, *Supreme Court* Gabelli *decision will continue to bring changes to SEC enforcement policy*, *supra* note 39; *High Court Ruling May Shut Out SEC Financial Crisis Cases*, BOARDIQ (Mar. 12, 2013), http://www.boardiq.com/pc/484821/54251.

[41] *See* Svea Herbst-Bayliss and Tim McLaughlin, *Massachusetts may seek federal help on Puerto Rico debt probe*, REUTERS (Oct. 23, 2013), http://www.reuters.com/article/2013/10/23/us-puertorico-debt-massachusetts-idUSBRE99M17J20131023.

[42] *See 2014 Regulatory and Examination Priorities Letter*, FINRA (Jan. 2, 2014), *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@guide/.../p419710.pdf. Indeed, in February 2014, FINRA levied the highest-ever fine against a firm for, among other things, failure to implement an adequate anti-money laundering program to monitor and detect certain suspicious transactions. *See* News Release, FINRA, FINRA Fines Brown Brothers Harriman a Record $8 Million for Substantial Anti-Money Laundering Compliance Failures, Feb. 5, 2014, http://www.finra.org/Newsroom/NewsReleases/2014/P443442.

[43] 15 U.S.C. § 80a-35(b) (2007).

[44] Jones v. Harris Assocs. L.P., 130 S. Ct. 1418 (2010). This standard was first articulated by a federal appellate court in Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 694 F.2d 923 (2d Cir. 1982).

[45] Jones v. Harris Assocs. L.P., No. 07-1624 (7th Cir. filed Mar. 20, 2007), *remanded from* Jones v. Harris Assocs. L.P., 130 S. Ct. 1418 (2010).

[46] Four of the fourteen post-*Jones* cases were filed in early 2014: Fox v. BlackRock Advisors, LLC, No. 3:14-cv-2097 (D.N.J. filed Apr. 3, 2014); Foote v. BlackRock Advisors, LLC, No. 3:14-cv-1991 (D.N.J. filed Mar. 28, 2014); Clancy v. BlackRock Inv. Mgmt., LLC, No. 3:14-cv-1165 (D.N.J. filed Feb. 21, 2014); and Zehrer v. Harbor Capital Advisors, Inc., No. 1:14-cv-789 (N.D. Ill. filed Feb. 4, 2014).

Five of the fourteen post-*Jones* cases were filed in 2013: Curd v. SEI Investments Mgmt. Corp., No. 2:13-cv-7219 (E.D. Pa. filed Dec. 11, 2013); McClure v. Russell Commodity Strategies Fund, 1:13-cv-12631 (D. Mass. filed Oct. 17, 2013); Cox v. ING Investments LLC, 1:13-cv-1521 (D. Del. filed Aug. 30, 2013); Am. Chemicals & Equipment Inc. 401(k) Ret. Plan v. Principal Mgmt. Corp., No. 2:13-cv-1601 (N.D. Ala. filed Aug. 28, 2013); and Laborer's Local 265 Pension Fund v. iShares Trust, No. 13-cv-46 (M.D. Tenn. filed Jan. 18, 2013).

The remaining five of the fourteen post-*Jones* cases were filed in 2010-2011: Reso v. Artisan Partners Ltd. P'ship, 11-cv-873 (E.D. Wisc. filed Sept. 16, 2011); Sivolella v. AXA Equitable Life Ins. Co., No. 11-cv-4194 (D.N.J. filed July 21, 2011); Kasilag v. Hartford Inv. Fin. Servs. LLC, No. 1:11-cv-1083 (D.N.J. filed Feb. 25, 2011); Southworth v. Hartford Inv. Fin. Servs. LLC, No. 10-cv-878 (D. Del. filed Oct. 14, 2010); Santomenno v. John Hancock Life Ins. Co., No. 2:10-cv-1655 (D.N.J. filed Mar. 31, 2010).

The count of post-*Jones* lawsuits set forth in this publication does not include: (1) Sanford v. AXA Equitable Funds Mgmt. Group, LLC, No. 3:13-cv-312 (D.N.J. filed Jan. 15, 2013), which was consolidated into an earlier case, Sivolella v. AXA Equitable Life Ins. Co., No. 11-cv-4194 (D.N.J. filed July 21, 2011); or (2) Kasilag v. Hartford Funds Mgmt Co. LLC 1:14-cv-1611 (D.N.J. filed Mar. 12, 2014), which has been requested, by joint stipulation of the parties, to be consolidated into an earlier case, Kasilag v. Hartford Inv. Fin. Serv., LLC, No. 1:11-cv-1083 (D.N.J. filed Feb. 25, 2011).

[47] Two of these post-*Jones* lawsuits were dismissed in 2011 and 2012. *See* Reso v. Artisan Partners Ltd. P'ship, No. 11-cv-873 (E.D. Wis. Aug. 23, 2012) (order dismissing with prejudice pursuant to a stipulation of the parties); Southworth v. Hartford Inv. Fin. Servs. LLC, No. 10-cv-878 (D. Del. filed Oct. 14, 2010) (voluntarily dismissed by the plaintiffs in November 2011).

[48] Cox v. ING Investments LLC, 1:13-cv-1521 (D. Del. filed Aug. 30, 2013) (motion to transfer to D. Ariz. pending); McClure v. Russell Commodity Strategies Fund, 1:13-cv-12631 (D. Mass. filed Oct. 17, 2013); Curd v. SEI Investments Mgmt. Corp., No. 2:13-cv-7219 (E.D. Pa. filed Dec. 11, 2013) (motion to dismiss pending); Zehrer v. Harbor Capital Advisors, Inc., No. 1:14-cv-789 (N.D. Ill. filed Feb. 4, 2014) (motion to dismiss pending). Another recent case, filed in November 2013, similarly focuses on the comparative level of fees paid to advisers and to subadvisers, but does so in the ERISA context rather than under section 36(b). Gordan v. Mass. Mut. Life Ins. Co., No. 13-cv-30184 (D. Mass. filed Nov. 5, 2013) (motion to dismiss pending).

[49] Am. Chemicals & Equipment Inc. 401(k) Ret. Plan v. Principal Mgmt. Corp., 2:13-cv-1601 (N.D. Ala. filed Aug. 28, 2013).

[50] Am. Chemicals & Equipment Inc. 401(k) Ret. Plan v. Principal Mgmt. Corp., No. 4:14-cv-44 (S.D. Iowa filed Feb. 7, 2014).

[51] Curran v. Principal Mgmt. Corp., LLC, No. 09-cv-433 (S.D. Iowa June 12, 2013) (dismissed with prejudice after parties reached settlement).

[52] Clancy v. BlackRock Inv. Mgmt., LLC, No. 3:14-cv-1165 (D.N.J. filed Feb. 21, 2014).

[53] Fox v. BlackRock Advisors, LLC, No. 3:14-cv-02097 (D.N.J. filed Apr. 3, 2014); Foote v. BlackRock Advisors, LLC, No. 3:14-cv-1991 (D.N.J. filed Mar. 28, 2014).

[54] Laborer's Local 265 Pension Fund v. iShares Tr., No. 13-cv-46 (M.D. Tenn. Oct. 24, 2013), *appeal docketed*, No. 13-6486 (6th Cir. Nov. 8, 2013).

[55] Kasilag v. Hartford Inv. Fin. Servs. LLC, No. 1:11-cv-1083 (D.N.J. filed Feb. 25, 2011). In September 2011, the court granted in part and denied in part the defendant's original motion to dismiss. Thereafter, the plaintiffs filed an amended complaint; in December 2012, the court denied in part and granted in part the defendant's motion to dismiss the amended complaint. Kasilag v. Hartford Inv. Fin. Servs. LLC, 2012 U.S. Dist. LEXIS 178234 (D.N.J. Dec. 17, 2012).

[56] Sivolella v. AXA Equitable Life Ins. Co., No. 11-cv-4194 (D.N.J. Sept. 25, 2012) (motion to dismiss denied in part and granted in part). In early 2013, a similar section 36(b) complaint was filed against the same fund group; this lawsuit was subsequently consolidated into *Sivolella*. Sanford v. AXA Equitable Funds Mgmt. Group, LLC, No. 3:13-cv-312 (D.N.J. filed Jan. 15, 2013). On April 15, 2013, the plaintiffs filed a second amended complaint, in which they also challenged, under section 36(b), the *administrative* fees paid to the advisers by the funds.

[57] Specifically, in addition to alleging a section 36(b) violation with respect to the advisory fees charged to mutual funds offered as investment options in certain retirement plans, the plaintiffs in the underlying lawsuit alleged that the defendants charged the plans and, indirectly, plan participants, "unreasonable and excessive fees," and thereby breached their fiduciary duties under ERISA and engaged in prohibited transactions in violation of ERISA. Santomenno v. John Hancock Life Ins. Co., 2011 U.S. Dist. LEXIS 55317 (D.N.J. May 23, 2011).

A similar case was filed in early 2011 by the same plaintiffs' lawyers against another insurance company and certain affiliated investment advisers. Santomenno v. Transamerica Life Ins. Co., No. 11-736 (D.N.J. filed Feb. 8, 2011). That lawsuit also challenged fees under ERISA and sought to recover advisory fees, but, rather than alleging violation of section 36(b), the lawsuit sought to recover certain fees based on the allegation that one defendant acted as an unregistered investment adviser in violation of IAA section 203. The lawsuit was transferred to a federal district court in California, and in February 2013, the court granted a motion to dismiss with respect to the IAA claim, but denied the motion with respect to the ERISA claims. Santomenno v. Transamerica Life Ins. Co., 2013 U.S. Dist. LEXIS 22354 (C.D. Cal. Feb. 19, 2013).

[58] Santomenno v. John Hancock Life Ins. Co., 677 F.3d 178 (3d Cir. 2012).

[59] Santomenno v. John Hancock Life Ins. Co., 2013 U.S. Dist. LEXIS 103404 (D.N.J. July 24, 2013), *appeal docketed*, No. 13-4367 (3rd Cir. Aug. 14, 2013).

[60] Turner v. Davis Selected Advisers, L.P., No. 4:08-cv-421 (D. Ariz. Mar. 19, 2013) (order denying motion to alter or amend the judgment), *appeal docketed*, No. 13-15742 (9th Cir. Apr. 16, 2013).

[61] Curran v. Principal Mgmt. Corp., LLC, No. 09-cv-433 (S.D. Iowa June 12, 2013) (dismissed with prejudice after parties reached settlement).

[62] Halebian v. Berv, 631 F. Supp. 2d 284 (S.D.N.Y. 2007).

[63] Halebian v. Berv, 869 F. Supp. 2d 420 (S.D.N.Y. 2012).

[64] Halebian v. Berv, 2013 U.S. App. LEXIS 22801 (2d Cir. 2013), *reh'g denied*, No. 12-3360 (2nd Cir. Jan. 22, 2014).

[65] ICI Mutual's 2010 risk management study, MUTUAL FUND PROSPECTUS LIABILITY, *available at* http://www.icimutual.com, provides an overview of such lawsuits and the fund industry's experience in this area.

[66] In re Reserve Primary Fund Secs. & Derivative Class Action Litig., No. 1:08-cv-8060 (S.D.N.Y. Sept. 30, 2012); In re Oppenheimer Rochester Funds Group Secs. Litig., 2012 U.S. Dist. LEXIS 6975 (D. Colo. Jan. 20, 2012); Zametkin v. Fidelity Mgmt. & Research Co., No. 1:08-cv-10960 (D. Mass. Nov. 16, 2010); In re Morgan Keegan Secs., Derivative & ERISA Litig., 2010 U.S. Dist. LEXIS 104246 (W.D. Tenn. Sept. 30, 2010); In re Evergreen Ultra Short Opportunities Fund Secs. Litig., 705 F. Supp. 2d 86 (D. Mass. 2010); Gosselin v. First Trust Advisors L.P., 2009 U.S. Dist. LEXIS 117737 (N.D. Ill. Dec. 17, 2009); In re Charles Schwab Corp. Secs. Litig., 257 F.R.D. 534, 2009 U.S. Dist. LEXIS 8125 (N.D. Cal. 2009). The one exception was Yu v. State Street Corp., 774 F. Supp. 2d 584 (S.D.N.Y. 2011), in which the court granted the motion to dismiss.

[67] In re Oppenheimer Champion Fund Secs. Fraud Class Actions, No. 1:09-cv-386 (D. Colo. Sept. 30, 2011) & Ferguson v. OppenheimerFunds, Inc., No. 1:09-cv-1186 (D. Colo. Sept. 30, 2011) (final settlement of both lawsuits); Zametkin v. Fidelity Mgmt. & Research Co., No. 1:08-cv-10960 (D. Mass. May 11, 2012) (final settlement); Gosselin v. First Trust Advisors L.P., 2009 U.S. Dist. LEXIS 117737 (N.D. Ill. Dec. 17, 2009) (final settlement); In re Charles Schwab Corp. Secs. Litig., 2011 U.S. Dist. LEXIS 44547 (N.D. Cal. Apr. 19, 2011) (final settlement); In re Evergreen Ultra Short Opportunities Fund Secs. Litig., 2012 U.S. Dist. LEXIS 174711 (D. Mass. Dec. 10, 2012) (final settlement); Yu v. State St. Corp., No. 1:08-cv-8235 (S.D.N.Y. Sept. 6, 2012) (final settlement).

[68] In re Oppenheimer Rochester Funds Group Secs. Litig., No. 1:09-md-2063 (D. Colo. Mar. 12, 2014) (preliminary approval of settlement); In re Morgan Keegan Closed-End Fund Litig., No. 2:07-cv-2830 (W.D. Tenn. Aug. 5, 2013) (final settlement); In re Reserve Primary Fund Secs. & Derivative Class Action Litig., No. 1:08-cv-8060 (S.D.N.Y. Jan. 13, 2014) (final settlement).

[69] *See* In re Morgan Keegan Open-End Mutual Fund Litig., No. 2:07-cv-2784 (W.D. Tenn. filed Dec. 6, 2007) (partial settlement awaiting court approval).

[70] Rafton v. Rydex Series Funds, No. 5:10-cv-1171 (N.D. Cal. Feb. 10, 2012) (final approval of settlement); Rafton v. Rydex Series Funds, 2011 U.S. Dist. LEXIS 707 (N.D. Cal. Jan. 5, 2011) (order granting in part and denying in part motion to dismiss).

[71] In re Direxion Shares ETF Tr., No. 1:09-cv-8011 (S.D.N.Y. May 10, 2013) (final judgment and order of dismissal).

[72] In re ProShares Tr. Secs. Litig. v. ProShares Trust, 728 F.3d 96, 108-09 (2d Cir. 2013).

[73] Janus Capital Group v. First Derivative Traders, 131 S. Ct. 2296 (2011).

[74] Applying *Janus*, two courts have found that law firms were not deemed to have "made" allegedly misleading statements in publicly filed documents drafted on behalf of their clients. *See* In re DVI Inc. Secs. Litig., 2013 U.S. Dist. LEXIS 1258, *24-*25 (E.D. Pa. Jan. 4, 2013) (law firm not liable for statements in public filing that were not publicly made by the firm itself) and ESG Capital Partners, LP & Limited Partners v. Troy Stratos, No. 13-cv-01639 (C.D. Cal. June 26, 2013) (law firm not liable for statement in public filing when client directed the content of the representations). However, when a law firm provided an opinion, it was deemed to have ultimate control over its statements therein. *See* SEC v. Garber, 959 F. Supp. 2d 374, 381-82 (S.D.N.Y. 2013).

Whether, and to what extent, *Janus* applies to actions brought by the SEC is still being explored by the courts; however, in several cases, the SEC has not contested *Janus*' applicability to its enforcement actions. *See* SEC v. Benger, 931 F. Supp. 2d 908, 912 (N.D. Ill. 2013) (citing several cases in which the SEC declined to contest the applicability of *Janus*) (citations omitted).

[75] *See* In re Smith Barney Fund Transfer Agent Litig., 884 F. Supp. 2d 152 (S.D.N.Y. 2012).

[76] *See* In re Smith Barney Fund Transfer Agent Litig., No. 1:05-cv-7583 (S.D.N.Y. Oct. 7, 2013) (order preliminarily approving settlement).

[77] The "fraud-on-the-market" theory presumes that negative news about a company has been incorporated into the price of the company's security in the marketplace, and plaintiffs may therefore rely on the price of the security as reflecting all publicly available information about the company. The Fifth Circuit challenged the validity of the presumption in April 2013, and the U.S. Supreme Court thereafter granted certiorari. *See* Erica P. John Fund, Inc. v. Halliburton Co., No. 12-10544, 718 F.3d 423 (5th Cir. 2013), *cert. granted*, 134 S. Ct. 636 (2013) (No. 13-317).

[78] *See* Alison Frankel, *At Halliburton argument, justices show little appetite for killing* Basic, REUTERS (Mar. 5, 2014), http://blogs.reuters.com/alison-frankel/2014/03/05/at-halliburton-argument-justices-show-little-appetite-for-killing-basic/

[79] The coverage also requires the insured to obtain ICI Mutual's advance consent before incurring any costs for which the insured may seek reimbursement. *See generally* ICI Mutual's 2009 Risk Management Study, MUTUAL FUND D&O/E&O INSURANCE (at pp. 35-36, discussing insurance for the costs of correcting operations-based errors).

[80] *See generally* ICI Mutual's 2011 Risk Management Study, MANAGING OPERATIONAL RISKS OF PRIVATE ACCOUNTS (at pp. 12-13, describing the overreliance on automated compliance systems as one of the recurring themes in private advisory claims).

[81] Efforts by the plaintiffs' bar to utilize state law class actions and state law derivative actions may reflect the narrowing in recent years of other legal avenues available to them for attacks on the fund industry. In particular, the courts, in a number of decisions over the past decade, have refused to find "implied" rights of action under various provisions of the ICA. *See*, *e.g.*, Smith v. Oppenheimer Funds Distrib., Inc., Nos. 10-cv-7387 & 10-cv-7394 (S.D.N.Y. June 6, 2011) (ICA § 47(b)); Northstar Fin. Advisors, Inc. v. Schwab Invs., 615 F.3d 1106 (9th Cir. 2010) (ICA § 13(a)); Bellikoff v. Eaton Vance Corp., 481 F.3d 110, 117 (2d Cir. 2007) (ICA §§ 34(b), 36(a), and 48(a)); Olmsted v. Pruco Life Ins. Co. of N.J., 283 F.3d 429, 436 (2d Cir. 2002) (ICA §§ 26(f) and 27(i)).

[82] These dismissals came in 2009 and 2010, with the Second Circuit affirming the dismissals of two of these lawsuits in November 2009 and June 2011, respectively, and with the Ninth Circuit affirming the dismissal of another lawsuit in May 2011. *See* McBrearty v. Vanguard Group, Inc., 353 Fed. Appx. 640 (2d Cir. 2009); Seidl v. Am. Century Cos., 427 Fed. Appx. 35 (2d Cir. 2011); Wodka v. Causeway Capital Mgmt. LLC, 433 Fed. Appx. 563 (9th Cir. 2011).

[83] Gamoran v. Neuberger Berman, LLC, 2012 U.S. Dist. LEXIS 82085 (S.D.N.Y. June 12, 2012).

[84] Gamoran v. Neuberger Berman LLC, 2013 U.S. Dist. LEXIS 45887 (S.D.N.Y. Mar. 29, 2013) (granting motion to dismiss amended complaint).

[85] Gamoran v. Neuberger Berman LLC, 536 Fed. Appx. 155 (2d Cir. 2013) (affirming district court's judgment, but vacating district court's conclusion on legality of investments under state law, because it was not necessary to reach the issue); Gamoran v. Neuberger Berman LLC No. 1:11-cv-7957 (S.D.N.Y. Nov. 27, 2013) (order dismissing lawsuit with prejudice).

[86] Hartsel v. Vanguard Group, Inc., 2012 Del. LEXIS 23 (Del. 2012).

[87] Hartsel v. Vanguard Group Inc., No. 13-cv-1128 (D. Del. filed June 24, 2013).

[88] Gomes v. Am. Century Cos., 2012 U.S. Dist. LEXIS 187426 (W.D. Mo. Feb. 16, 2012), *aff'd* No. 12-1639 (8th Cir. Mar. 28, 2013); Gomes v. Am. Century Cos., No. 14-cv-283 (W.D. Mo. filed Mar. 26, 2014).

[89] Seidl v. Am. Century Cos., No. 4:10-cv-4152 (W.D. Mo. Oct. 31, 2012) (denying motion to dismiss).

[90] Wodka v. Causeway Capital Mgmt. LLC, No. BC463623 (Cal. Super. Ct. Nov. 26, 2013) (judgment entered on Jan. 23, 2014) (notice of appeal filed by plaintiff on March 19, 2014).

[91] *See* Averbuch v. Arch, No. 2011-2502 (Sup. Ct. Mass. Aug. 26, 2013) (dismissed with prejudice); Curbow v. BlackRock Advisors, LLC, No 651104-2010 (N.Y. Sup. Ct. June 10, 2013) (discontinued by court without prejudice).

[92] *See* Curbow Family LLC v. Morgan Stanley Inv. Advisors, Inc., No. 651059-2010 (N.Y. Sup. Ct. filed July 22, 2010); Rotz v. Van Kampen Asset Mgmt., Inc., No. 651060-2010 (N.Y. Sup. Ct. filed July 22, 2010).

[93] *See, e.g.*, Hartsel v. Vanguard Group, Inc., 2011 Del. Ch. LEXIS 89 (2011), *aff'd*, 38 A.3d 1254 (Del. 2012); Seidl v. Am. Century Cos., Inc., 713 F. Supp. 2d 249, 257-62 (S.D.N.Y. 2010), *aff'd*, 427 Fed. Appx. 35 (2d Cir. 2011); In re Eaton Vance Mut. Funds Fee Litig., 380 F. Supp. 2d 222 (S.D.N.Y. 2005), *aff'd*, Bellikoff v. Eaton Vance Corp., 481 F.3d 110 (2d Cir. 2007).

[94] Union de Empleados de Muelles de P.R. PRSSA Welfare Plan v. UBS Fin. Servs. Inc. of P.R., 704 F.3d 155, *cert. granted*, No. 12-1208 (June 24, 2013), *dismissed* Aug. 26, 2013.

[95] Halebian v. Berv, 869 F. Supp. 2d 420 (S.D.N.Y. 2012). The lawsuit had essentially asserted that the trustees "failed to avail themselves of the opportunity to negotiate lower fees or seek competing bids from other qualified investment advisors." Halebian v. Berv, 631 F. Supp. 2d 284, 289 (S.D.N.Y. 2007).

[96] Halebian v. Berv, 2013 U.S. App. LEXIS 22801 (2d Cir. Nov. 12, 2013).

[97] Gamoran v. Neuberger Berman LLC, 2013 U.S. Dist. LEXIS 45887 (S.D.N.Y. Mar. 29, 2013) (granting motion to dismiss amended complaint). In its decision, the court also observed that, by filing a demand with the board, the plaintiff "tacitly acknowledge[d] the absence of facts to support a finding of [demand] futility" and was therefore precluded under Delaware law from challenging the independence or disinterestedness of the committee of the fund board that had conducted an SDDI prior to a rejection of the plaintiff's demand. The court also determined that the plaintiff's allegations did "not implicate the reasonableness of the board's investigation and fail[ed] to demonstrate that the board's refusal was made in bad faith." *Id.* at *14-*16.

[98] Gamoran v. Neuberger Berman LLC, 536 Fed. Appx. 155 (2d Cir. 2013) (affirming district court's judgment, but vacating district court's conclusion on legality of investments under state law, because it was not necessary to reach the issue); Gamoran v. Neuberger Berman LLC, No. 1:11-cv-7957 (S.D.N.Y. Nov. 27, 2013) (order dismissing lawsuit with prejudice).

[99] Santomenno v. John Hancock Life Ins. Co., No. 2:10-cv-1655 (July 24, 2013), *appeal docketed*, No. 13-4367 (3rd Cir. Aug. 14, 2013).

[100] Tussey v. ABB Inc., 2012 U.S. Dist. LEXIS 45240 (W.D. Mo. Mar. 31, 2012).

[101] Tussey v. ABB Inc., 2014 U.S. App. LEXIS 5118 (8th Cir. 2014).

[102] *Id.*

[103] Brown v. Fidelity Mgmt. & Research Co., 1:13-cv-11011 (D. Mass. filed Apr. 25, 2013); Columbia Air Srvs. Inc. v. Fidelity Mgmt. Tr. Co., No. 1:13-cv-10570 (D. Mass. filed Mar. 11, 2013); Boudreau v. Fidelity Mgmt. & Tr. Co., No. 1:13-cv-10524 (D. Mass. filed Mar. 7, 2013); and Kelley v. Fidelity Mgmt. & Tr. Co., No: 1:13-cv-10222 (D. Mass. filed Feb. 5, 2013). The cases have been consolidated as In re Fidelity ERISA Float Litig., No. 1:13-cv-10222 (D. Mass. filed Feb. 5, 2013) (motion to dismiss filed on March 7, 2014).

[104] Bilewicz v. FMR LLC, No. 1:13-cv-10636 (D. Mass. filed Mar. 19, 2013).

[105] Yeaw v. FMR LLC, 1:14-cv-10035 (D. Mass. filed Jan. 7, 2014).

[106] Gordan v. Mass. Mut. Life Ins. Co., No. 13-30184 (D. Mass. filed Nov. 5, 2013) (motion to dismiss filed on Jan. 14, 2014).

[107] McCaffree Fin. Corp. v. Principal Life Ins. Co., No 4:14-cv-102 (S.D. Iowa filed Mar. 18, 2014).

[108] Prudential Ret. Ins. and Annuity Co. v. State St. Bank and Tr. Co., 2012 U.S. Dist. LEXIS 13556 (S.D.N.Y. Feb. 3, 2012).

[109] Prudential Ret. Ins. and Annuity Co. v. State St. Bank and Tr. Co., No. 07-8488 (S.D.N.Y. Jan. 28, 2013).

[110] Glass Dimensions, Inc. v. State Street Bank & Tr. Co., No. 1:10-cv-10588 (D. Mass. filed Apr. 8, 2010).

[111] Glass Dimensions, Inc. v. State Street Bank & Tr. Co., No. 1:10-cv-10588 (D. Mass. Jan. 27, 2014) (order preliminarily approving settlement).

[112] *See*, *e.g.*, Kirschner v. FitzSimons, No. 1:10-ap-54010 (Bankr. D. Del. filed Nov. 1, 2010) & Off. Comm. of Unsecured Creditors of Tribune Co. v. JPMorgan Chase Bank, N.A., 1:10-ap-55841 (Bankr. D. Del. Mar. 26, 2013) (dismissed) (both adversarial proceedings in In re Tribune Co., No. 1:08-bk-13141 (Bankr. S.D.N.Y. filed Dec. 8. 2008)); In re Tribune Co. Fraudulent Conveyance Litig., No. 11-md-2296 (S.D.N.Y. filed Dec. 20, 2011); Weisfelner v. Fund 1, No. 10-ap-4609 (Bankr. S.D.N.Y. filed Dec. 1, 2010) & Weisfelner v. Hoffman, No. 10-ap-05525 (Bankr. S.D.N.Y. filed Dec. 23, 2010) (both adversarial proceedings in In re Lyondell Chem. Co., No. 1:09-bk-10023 (Bankr. S.D.N.Y. filed Jan. 6, 2009)).

[113] In re Tribune Co. Fraudulent Conveyance Litig., No. 11-md-2296 (S.D.N.Y. Sept. 23, 2013).

[114] In re Tribune Co. Fraudulent Conveyance Litig., No. 13-3992 (2d Cir. filed Oct. 1, 2013), Nos. 13-3875 & 13-4178 (2d Cir. filed Oct. 29, 2013), and No. 13-4196 (2d Cir. filed Oct. 31, 2013).

[115] Weisfelner v. Fund 1, No. 10-ap-4609 (Bankr. S.D.N.Y. Jan. 14, 2014) (adversarial proceeding in In re Lyondell Chem. Co., No. 1:09-bk-10023 (Bankr. S.D.N.Y. filed Jan. 6, 2009)).

[116] Lawson v. FMR LLC, 134 S. Ct. 1158 (2014), *reversing* Lawson v. FMR LLC, 670 F.3d 61 (1st Cir. 2012).

[117] Lawson v. FMR LLC, 724 F. Supp. 2d 141 (D. Mass. 2010).

[118] *See, e.g.*, *In* Lawson*, Supreme Court Expands SOX Whistleblower Protection to Employees of Private Contractors*, Goodwin Proctor Alert (Mar. 14, 2014), http://www.goodwinprocter.com/Publications/Newsletters/Client-Alert/2014/0314_In-Lawson_Supreme-Court-Expands-SOX-Whistleblower-Protection-to-Private-Contractors.aspx (suggesting that the ruling could lead to "a spate of litigation" brought by employees of private companies contracting with public companies); *The Supreme Court of the United States Opens the Door to Additional Whistleblower Claims and Shareholder Litigation*, Kaufman Dolovich Voluck Alert (Mar. 10, 2014), http://kdvlaw.com/publication/kdv-alert-the-supreme-court-of-the-united-states-opens-the-door-to-additional-whistleblower-claims-and-shareholder-litigation/ (suggesting that increased disclosures of wrongdoing by whistleblowers might lead to an increase in civil litigation); *The U.S. Supreme Court Extends Sarbanes-Oxley Whistleblower Protections to Employees of Mutual Fund Investment Advisers and Other Privately-Held Contractors to Public Companies*, Legal Update (Mar. 2014), http://sites.edechert.com/10/3110/march-2014/supreme-court-extends-sox-whistleblower-protections-to-employees-of-mutual-fund-investment-advisers-and-other-privately-held-contractors-to-public-companies.asp?forward=a4084bbf-ad01-479f-844e-f0fe7c34cd2a (opining that ruling "exposes privately-held investment advisers of, and other privately-held contractors to, mutual funds and other public companies to a broad swath of potential claims").

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