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Fighting over Mutual-Fund Fees

The U.S. Supreme Court is scheduled to hear a case regarding excessive mutual-fund fees this fall at a time when the court of public opinion is decrying inappropriate compensation packages at every turn.

By Paul Gallagher

From practically the first moments of the recession, the tide of consumer anger and resentment over the appearance of inappropriate compensation practices has risen unabated. That anger contributed to creating "say on pay" legislation, which may have an effect on reining in what has been called out-of-control executive compensation practices at some companies.

One such bill, introduced by Rep. Barney Frank, D-Mass., is called the Corporate and Financial Institution Compensation Fairness Act of 2009. It requires that all publicly traded companies submit information regarding executive compensation packages, as well as "golden parachute" packages, to shareholders for a nonbinding vote. The bill passed in the House on July 31, and is currently before the Senate.

In the court of public opinion, businesses considering excessive compensation practices might as well be giving themselves a hotfoot.

The subject has even made its way to the U.S. Supreme Court, which is scheduled to hear the case of *Jones vs. Harris Associates* this fall. The case concerns allegedly excessive fees paid by mutual funds to their investment advisers.

Last summer, a three-judge panel in the U.S. 7th Circuit Court of Appeals in Chicago rejected the lawsuit brought by investors, who charged that three Oakmark mutual funds had overpaid their investment adviser. Chief Judge Frank H. Easterbrook wrote in the opinion that the marketplace should determine whether such fees were excessive.

In his dissent opinion, however, Judge Richard A. Posner said the marketplace can't always be trusted to regulate such fees. Further, he said, executive compensation is spinning out of control and is not adequately regulated.

That Posner and Easterbrook should disagree to such an extent practically guaranteed that the case would be brought before the Supreme Court, says Robert C. Christenson, a partner in the Atlanta office of Fisher & Phillips.

"Posner and Easterbrook are kind of legends of the Chicago economic theory of legal analysis," says Christenson. "They're market people. To me, that's significant. You have two guys here, Posner and Easterbrook, who are scions of the market theory of economics and legal analysis, coming out on different sides of an issue that has other ramifications, such as executive compensation."

The central issue of *Jones vs. Harris Associates* is a critical issue for employers, says Christenson. Employers that provide 401(k) plans must be cautious about whether the plans they choose for employees are charging appropriate fees.

According to the Investment Company Institute, a national association of U.S. investment companies headquartered in Washington, more than \$9.6 trillion was invested in mutual funds in 2008. Fees in funds can range from .35 percent of assets to 1.72 percent.

"You have a fiduciary obligation to the [employee] who's picking out these funds to pick out an appropriate fund, and you've got to do due diligence," Christenson says.

That may be possible if you're Warren Buffet, but for most HR leaders who act as fiduciaries, it may be more difficult to find 401(k) plan advisers that don't appear to charge excessive fees, Christenson says, noting that such expert advice in administering and selecting retirement funds is necessary, however.

Andrew C. W. Lund, an associate professor at Pace Law School in White Plains, N.Y., says whoever is charged with overseeing an employer's 401(k) plan should study the fees associated with the funds, even if the business is using consultants to assist them. He adds, however, that he's uncertain that excessive fees ultimately make a real dent in an individual's returns.

"Excessive compensation reduces the returns to a 401(k)," he says. "Is it a big number? No, it's not going to be a big number for any particular account holder."

Despite the limited impact of those fees relative to the overall investment., Lund says, excessive charges still should not be allowed.

"The whole point of [Posner's dissent] is that there's not much of a market share, and that people don't shop around," he says. "If people aren't shopping around for the best deal, then there's something to be said for trying to mandate the best deal by imposing some restrictions."

Lund says he's impressed that Posner cited in his dissent what he felt were anarchic executive-compensation packages.

Although the issue involved in the case pending before the High Court and the subject of executive compensation are different issues, he says, "there are two different courts we're talking about here. There's the court of public opinion issue and there's the legal issue."

Regardless of how the Supreme Court rules, Lund speculates that the mass media could follow the case and stoke public anger, "saying that compensation is broken, and we agree with Posner that, not only is it broken in the mutual-fund context, but it may very well be broken in the public company context."

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