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16 **UNITED STATES DISTRICT COURT FOR THE**
 17
 18 **CENTRAL DISTRICT OF CALIFORNIA**

19	RACHELLE KORLAND, ON)	Case No. CV 08-04020 GAF (RNBx)
20	BEHALF OF THE EUROPACIFIC)	
21	GROWTH FUND,)	PLAINTIFF’S MEMORANDUM
22	Plaintiff,)	OF POINTS & AUTHORITIES
23)	OPPOSING DEFENDANTS’
24)	MOTION TO DISMISS
25	vs.)	
26	CAPITAL RESEARCH AND)	Judge: Hon. Gary A. Feess
27	MANAGEMENT COMPANY, et)	Current Date: January 12, 2009
28	al.)	Current Time: 9:30 a.m.
)	Place: Courtroom 740
	Defendant(s).)	255 E. Temple Street
)	Los Angeles, CA 90012

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1 the extent that these fees were within the ambit of the rule, and despite the enormous
2 payments by the Fund to defendants, there were no economies of scale or, if there
3 were any economies, only the defendants and not the Fund and its shareholders
4 benefitted from them. The Complaint alleges that by charging these unauthorized
5 and excessive 12b-1 fees, defendants violated their fiduciary duties under Section
6 36(b) of the ICA. Plaintiff seeks to recover (beginning from June 18, 2007), for and
7 on behalf of the Fund, hundreds of millions of dollars in 12b-1 fees and rescission of
8 the 12b-1 plans under ICA § 47(b).

9 Plaintiff's claims are governed by Rule 8 of the Federal Rules of Civil
10 Procedure, which requires mere notice pleading. In the face of that immutable
11 principle, defendants' motion to dismiss erects various "straw man" arguments, each
12 of which falls upon scrutiny.

13 First, defendants incorrectly pigeonhole plaintiff's contention that certain
14 aspects of defendants' 12b-1 fees fall so clearly outside what the plain language of
15 Rule 12b-1 permits (itself a narrow exception to the previous complete statutory bar)
16 as to be inherently excessive – that is, unauthorized by the text of the rule, obviating
17 the need for an elaborate analysis of whether the fees were excessive and
18 disproportionate under *Gartenberg v. Merrill Lynch Asset Mgmt., Inc.*, 694 F.2d 923
19 (2d Cir. 1982), *cert. denied*, 461 U.S. 906 (1983). Defendants attack this threshold
20 definitional argument as an impermissible end-run around the so-called *Gartenberg*
21 factors for Section 36(b) cases. However, the cases defendants rely on that decline
22 to adopt *per se* rules on the facts presented are inapposite, as none directly involve
23 the threshold determination involved here as to whether the Fund's charges for post-
24 sale, routine account services that customer's brokers are already obligated to
25 provide fall into the narrow Rule 12b-1 sales-related exception.

26 By statutory mandate, 12b-1 fees can only be used to "finance activities" that
27 are "primarily intended to result in the sale of [Fund] shares." On their face, post-
28 sale shareholder services such as routine account maintenance tasks are not

1 “primarily intended to result in the sale of [Fund] shares” because the sale has
2 already occurred. If anything, the use of 12b-1 fees to pay for post-sale services
3 would by the plain reading of the statute violate the regulatory scheme.

4 Here, as the Complaint alleges, the 12b-1 fees paid for operational and
5 account maintenance activities that the broker-dealer was already legally obligated
6 to provide at the broker-dealer’s own expense. Since Rule 12b-1 requires that there
7 be “a reasonable likelihood that the [fees] will benefit the [Fund] and its
8 shareholders,” that could not be the case where the broker-dealer was legally
9 obligated to provide the service at its own expense and did not have to be induced to
10 provide that service in return for a payment. That suggests that the fees were
11 outside of the narrow scope of Rule 12b-1 and inherently excessive, without even
12 reaching the *Gartenberg* test. Where activities financed by 12b-1 fees (including,
13 but not limited to, post-sale shareholder services) are not “primarily intended to
14 result in the sale of [Fund] shares,” then a fund has strayed beyond what the rule
15 permits, and a Court should never have to reach the *Gartenberg* test.

16 On the other hand, even if some or all of the 12b-1 fees (whether post- or pre-
17 sale) are deemed to be “primarily intended” to result in the sale of Fund shares and
18 are to be scrutinized under a balancing test, they do not pass muster under the
19 *Gartenberg* test. Contrary to defendants’ assertion, the Complaint analyzes all of
20 the applicable *Gartenberg* factors, showing how the Rule 12b-1 fees assessed here
21 fall short of each of those factors. In addition, the Fund breached its fiduciary duties
22 because its Board of Directors failed to give the legally required consideration for its
23 annual approval to continue the Fund’s 12b-1 plans, considering each plan for only a
24 few minutes (Compl. ¶¶ 165-76) and failed to negotiate lower 12b-1 fees with
25 broker-dealers. *Id.* ¶¶ 177-82, 191.

26 Moreover, in addition to the *Gartenberg* factors, which were developed and
27 used exclusively in that decision to analyze investment advisory fees, Rule 12b-1
28 itself separately identifies nine factors that the SEC states “would normally be

1 relevant to a determination of whether to use fund assets for distribution.”
 2 Defendants’ use of Rule 12b-1 fees is impermissible under those criteria as well.
 3 Regardless of whether the SEC’s factors or the *Gartenberg* factors are applied, the
 4 outcome is the same under either test, and the Complaint readily shows that
 5 defendants’ conduct violates ICA Section 36(b). Compl. ¶ 183 n.11.²

6 Finally, defendants assert that the “control person” claim under ICA Section
 7 48(a) fails as a matter of law. For the reasons set forth below, this is incorrect under
 8 what plaintiff submits respectfully is better reasoned case law when a primary claim
 9 under Section 36(b) is properly alleged.

10 **III. ARGUMENT**

11 **A. Plaintiff Has Sufficiently Pled Defendants’ Violations of Rule 12b-1,** 12 **Giving Rise to Liability under Section 36(b) of the ICA**

13 The claims herein are governed by Rule 8 of the Federal Rules of Civil
 14 Procedure, which requires merely “a short and plain statement of the claim showing
 15 that the pleader is entitled to relief.” *Erickson v. Pardus*, 127 S. Ct. 2197, 2200
 16 (2007). Plaintiff’s well-pled violations of SEC Rule 12b-1, which give rise to
 17 defendants’ liability under ICA Section 36(b), clearly pass muster under this test.

18 Prior to the SEC’s adoption of Rule 12b-1 in 1980, it was unlawful under
 19 Section 12(b) of the ICA for a mutual fund to “to act as a distributor of securities of
 20 which it [wa]s the issuer.” One of the reasons this was so is because of the inherent
 21 conflicts in the operation of a mutual fund. Compl. ¶¶ 63-64. The SEC had
 22 recognized these conflicts, stating that “[m]utual funds are unique . . . in that they
 23
 24

25 ² Indeed, as discussed in Section III(C)(7), the Complaint’s analysis of the
 26 *Gartenberg* factors and the supplemental SEC factors is at least as rigorous as
 27 the amended complaint this Court sustained in related litigation concerning
 28 the same American Fund family of funds.

1 are ‘organized and operated by people whose primary loyalty and pecuniary interest
2 lie outside the enterprise.’” *Id.* ¶ 59.

3 In 1978, the SEC announced an “advance notice of proposed rulemaking”
4 concerning whether mutual funds should be permitted to use shareholder “assets to
5 pay expenses incurred in connection with the distribution of their shares.” The SEC
6 proposed the Rule 12b-1 exception for a number of reasons: net redemptions and
7 lack of growth in the mutual fund industry,³ and the desire to increase sales of
8 mutual fund shares to achieve perceived benefits to investors, including that there
9 might be economies of scale as the size of funds increased.

10 Rule 12b-1(a)(1) states in relevant part that, “it shall be unlawful for any
11 registered open-end management investment company ... to act as a distributor of
12 securities of which it is the issuer, except through an underwriter.” Subsection (2)
13 provides a limited exception “if [the company] engages directly or indirectly in
14 financing any activity which is *primarily intended to result in the sale of shares*
15 *issued by such company*, including, but not necessarily limited to, advertising,
16 compensation of underwriters, dealers, and sales personnel, the printing and mailing
17 of prospectuses to other than current shareholders, and the printing and mailing of
18 sales literature.” (Emphasis added.)

19 Subsection (e) of Rule 12b-1 provides that the approval or continuation of a
20 12b-1 plan is subject to the fiduciary duties set forth in ICA Section 36(b). Section
21 36(b) of the ICA states, in part, that “the investment adviser of a registered
22 investment company shall be deemed to have a fiduciary duty with respect to the
23 receipt of compensation for services, or of payments of a material nature, paid by
24 such registered investment company, or by the security holders thereof, to such

25
26 ³ At the time Rule 12b-1 was adopted in 1980, the mutual fund industry had
27 experienced net redemptions from 1973 – 1979, inclusive, in equity, hybrid and
28 bond mutual funds. In 1972, the industry had \$60 billion in assets, and in 1979 it
had \$49 billion in assets, in equity, hybrid and bond funds. Compl. ¶¶ 68-70.

1 investment adviser or any affiliated person of such investment adviser.” The
2 provision further states explicitly that a security holder of such registered investment
3 company may bring an action on behalf of such company, against such investment
4 adviser, or any affiliated person of such investment adviser, for breach of fiduciary
5 duty in respect of such compensation.

6 Courts and the SEC have broadly interpreted the scope of Section 36(b). It is
7 applicable when one of the statutorily designated recipients benefits from a breach
8 of fiduciary duty. *E.g.*, *Meyer v. Oppenheimer Mgmt. Corp.* (“*Meyer I*”), 764 F.2d
9 76, 82 (2d Cir. 1985), *citing* SEC Report, Public Policy Implications of Investment
10 Company Growth, H.R. Rep. No. 2337, 89th Cong., 2d Sess. 144 (1966).

11 Moreover, in proposing Rule 12b-1, the SEC emphasized that the Rule was
12 not intended “to reduce or limit in any way” the fiduciary duties imposed by section
13 36(b). *Meyer I*, at 82-83, *citing* Bearing of Distribution Expenses by Mutual Funds,
14 Investment Company Act Release No. 10,252 [1978 Transfer Binder] Fed. Sec. L.
15 Rep. (CCH) P 81,603, at 80,415. *See also* *Green v. Nuveen Advisory Corp.*, 186
16 F.R.D. 486, 491 (N.D. Ill. 1999).

17 Many courts have held that Section 36(b) applies to violations of Section 12
18 and Rule 12b-1 of the ICA, such as the inherently excessive fee claims alleged here.
19 *Meyer v. Oppenheimer Mgmt. Corp.*, 895 F.2d 861, 866 (2d Cir. 1990); *Meyer I*,
20 764 F.2d at 82-83 (reversing dismissal of section 36(b) claim); *Siemers v. Wells*
21 *Fargo & Co.*, 2006 U.S. Dist. LEXIS 60858, at *48-*61 (N.D. Cal. Aug. 14, 2006)
22 (motion to dismiss denied on merits, granted on procedural grounds); *Strigliabotti v.*
23 *Franklin Res., Inc.*, 2005 U.S. Dist. LEXIS 9625, at *20 (N.D. Cal. Mar. 7, 2005);
24 *Pfeiffer v. Bjurman, Barry & Assocs.*, 2004 U.S. Dist. LEXIS 16924, at *12
25 (S.D.N.Y. Aug. 27, 2004) (same); *Krinsk v. Asset Fund Mgmt.*, 715 F. Supp. 472,
26 485 (S.D.N.Y. 1988), *aff’d*, 875 F.2d 404 (2d Cir. 1989) (bench trial).

27

28

1 **B. A 12b-1 Fee May Violate Section 36(b) Without Regard to *Gartenberg***

2 Prior to the SEC's adoption of Rule 12b-1 in 1980, it was unlawful under
3 Section 12(b) of the ICA for a mutual fund "to act as a distributor of securities of
4 which it [wa]s an issuer." Compl. ¶ 63. In response to a stock market downturn in
5 the 1970s, which resulted in the net redemption of mutual funds, Rule 12b-1 was
6 adopted for the limited purpose of "financing any activity which is *primarily*
7 *intended* to result in the sale of shares issued by such company." Thus, it logically
8 follows that the use of shareholder funds to finance any activity not "primarily
9 intended" to result in the sale of Fund shares would be outside the parameter of the
10 lawful use of shareholder funds. Such use, financing an activity not primarily
11 related to the sale of fund shares, would be unauthorized or "excessive" as a matter
12 of law, and would not be subject to the *Gartenberg* analysis, which is a fact-based
13 balancing test applicable only to the statutorily permitted fees.

14 Courts have acknowledged that excessiveness under the *Gartenberg*
15 balancing test is not the only remediable violation of Section 36(b), but that other
16 more hard and fast violations are actionable. For example, in *Green v. Fund Asset*
17 *Mgmt., L.P.*, 19 F. Supp. 2d 227 (D.N.J. 1998), the court denied a motion to dismiss
18 a Section 36(b) claim where, without considering the *Gartenberg* factors, the fee
19 arrangement was rife with conflicts of interest. The court noted, "Section 36(b) of
20 the ICA is not expressly limited to situations in which the advisory fees received by
21 an investment advisor were excessive, disproportionate or otherwise unreasonable.
22 The statute encompasses the receipt of fees by an investment advisor in violation of
23 the advisor's fiduciary duty." *Id.* at 234 (citations omitted). *See also Rohrbaugh v.*
24 *Inv. Company Inst.*, 2002 U.S. Dist. LEXIS 13401, at *31-*32 (D.D.C. July 2, 2002)
25 ("a section 36(b) claim must either involve a challenge to excessive advisory fees
26 *per se* or to conduct that results in excessive advisory fees"). In other words, there
27 can be a violation of Section 36(b) not only because of excessive fees under
28

1 *Gartenberg*, but also because they are not permitted in the first instance because
2 they are not “primarily intended to result in the sale of [Fund] shares”.

3 The language of Rule 12b-1 itself confirms this analysis. The Rule expressly
4 identifies one example of an activity that a 12b-1 fee cannot be used to finance: it
5 includes among a list of permitted activities that are primarily intended to result in
6 the sale of fund shares the “mailing of prospectuses *to other than current*
7 *shareholders*” (Rule 12b-1(a)(2)), making it clear that such a mailing to existing
8 shareholders is outside the exception. Defendants cannot seriously contend that if a
9 mutual fund paid 12b-1 fees to a broker-dealer or underwriter for it to mail
10 prospectuses to current shareholders, then financing that activity would not be
11 expressly unauthorized by the rule; but, that it instead would be evaluated under the
12 *Gartenberg* factors. Indeed, defendants’ analysis would make every fund
13 management activity “primarily intended to result in the sale of [Fund] shares.”

14 Here, scores of millions of dollars in 12b-1 fees are used to pay for post-sale
15 shareholder services that cannot be “primarily intended to result in the sale of
16 [Fund] shares.” Account maintenance services such as regular account statements
17 do not highlight one security (they list all securities) or even relate to any particular
18 security in the account (but, instead, relate to all), thus eliminating any reason for
19 defendants to pay for such services. Moreover, the broker-dealer would provide
20 them in any event, irrespective of whether any mutual fund paid for the activities,
21 because it is legally obligated to do so. Compl. ¶¶ 10, 88, 90-91. The Fund and its
22 shareholders do not benefit from the Fund’s payment of 12b-1 fees for post-sale
23 shareholder services. The only beneficiaries are defendants.

24 Defendants mischaracterize plaintiff’s threshold definitional argument,
25 contending that plaintiff simply asserts it is a *per se* violation of section 36(b) when
26 12b-1 payments are used for improper purposes. Defs. Mem. at 9. This is
27 incorrect. What plaintiff asserts is that the Fund’s 12b-1 fees for shareholder
28

1 services on their face stray beyond the narrowly crafted permitted exception
2 contained in Rule 12b-1 and, thus, are by definition “excessive.”

3 Moreover, defendants also mischaracterize the case law, which they
4 incorrectly insist holds that there can never be a definitional violation of section
5 36(b) absent examination of the *Gartenberg* factors. The courts that have declined
6 to apply a *per se* rule, however, did so because of a failure, specific to each case, to
7 allege facts to make out a *per se* violation; not because there could be no actionable
8 violation outside of the economic *Gartenberg* factors.

9 In particular, three decisions cited by defendants – *Yameen v. Eaton Vance*
10 *Distribs., Inc.*, 394 F. Supp. 2d 350, 358 (D. Mass. 2005), *ING Principal Prot.*
11 *Funds Derivative Litig.*, 369 F. Supp. 2d 163, 168-9 (D. Mass. 2005), and *Goldman*
12 *Sachs Mut. Funds Fee Litig.*, 2006 U.S. Dist. LEXIS 1542, at *36 (S.D.N.Y. Jan.
13 17, 2006) -- each hold only that distribution fees taken from a closed fund were not
14 *per se* unlawful simply because the fees were used to pay deferred sales charges
15 incurred while the fund was open and the plaintiffs did not refute that the funds in
16 question would cease payments after they had fully compensated distributors on
17 previous sales. In *Yameen*, *ING* and *Goldman Sachs*, the plaintiffs failed to allege
18 that the defendants continued to take 12b-1 fees from the closed funds after they had
19 been completely reimbursed for their earlier sales-related expenses. In that
20 circumstance, the pleading of a specific economic fact that was not protected by the
21 12b-1 exception to the prohibition on distribution spending would have stated a
22 claim. Here, plaintiff alleges that the 12b-1 fees are outside of the carve-out and
23 that they were unauthorized because they were spent on non-distribution services.

24 Similarly, *In re Salomon Smith Barney Mut. Fund Fee Litig.*, 528 F. Supp. 2d
25 332, 338 (S.D.N.Y. 2007), and *In re Oppenheimer Funds Fees Litig.*, 426 F. Supp.
26 2d 157, 158 (S.D.N.Y. 2006), held only that where a *per se* claim is not sufficiently
27 alleged, then the *Gartenberg* economic test is applied. *Salomon* held that “where
28 the improper use of fees is not ‘excessive per se,’” the test is basically an economic

1 one, 528 F. Supp. 2d at 338, meaning there could be circumstances where a *per se*
2 claim would be sufficiently alleged. In *Oppenheimer*, plaintiff alleged that advisory
3 fees used to create a slush fund to bribe brokers were improper *per se*. The court
4 rejected that argument because plaintiff did not connect that assertion to any
5 allegation that the fees were materially disproportionate. 426 F. Supp. 2d at 158.
6 Unlike here, there was no claim in either *Salomon* or *Oppenheimer* that the fees in
7 question were expressly outside what was permitted by the ICA or any SEC rule.
8 (Defendants' other case on this point, *Bellikoff v. Eaton Vance*, 481 F.3d 110, 117
9 (2d Cir. 2007), does not even address the *per se* issue.)

10 In addition to overstretching the case law, defendants mischaracterize various
11 SEC pronouncements in arguing that there can be no *per se* violation of Rule 12b-1.
12 For example, the purportedly seminal document they cite (Defs. Mem. at 12-13),
13 ICA Release No. 16431 (1988), is a proposal to amend 12b-1. Defendants contend
14 that this Release holds that 12b-1 fees may be used to pay for non-distribution
15 shareholder services, and thus are subject to *Gartenberg* and cannot be *per se* out-
16 of-bounds. That release, however, merely states that some funds have paid for
17 shareholder services through a 12b-1 plan "apparently to address the possibility that
18 the payments may later be characterized as distribution expenditures." Critically,
19 the release states also that the expense must be a "*legitimate non-distribution*
20 *service.*" ICA Release 16431 at 40 (emph. added).

21 Defendants' whole argument is premised on the conclusion they jump to that
22 since 12b-1 fees may be used to pay for shareholder services that are not distribution
23 payments as such as long as they are "connected" to distribution, then such use can
24 never be *per se* forbidden by the rule. But, even assuming *arguendo* that defendants
25 may properly characterize these fees as service fees "connected to" distribution,
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1 none of defendants' citations⁴ address the most narrow situation presented here: is a
2 12b-1 payment for shareholder services that are unrelated to distribution *per se*
3 outside the scope of Rule 12b-1 because the payment can never be a "legitimate
4 non-distribution service" when the broker-dealer already is legally obligated to
5 provide the service to the shareholder?⁵ Plaintiff submits that, at least for pleading
6 purposes, the answer must be affirmative.

7 In any event, despite defendants' creating this straw man issue, we
8 respectfully suggest that there is nothing for this Court to decide on a motion to
9 dismiss with respect to a threshold definitional claim because it would still require
10 development of the factual record to demonstrate its existence. "Determining
11 whether this kind of fee arrangement constitutes a *per se* breach of fiduciary duty
12 requires an exploration of the economic realities of such funds and market
13 circumstances and practices. This determination cannot be made on the pleadings."
14 *Green*, 19 F. Supp. 2d at 235 (denying motion to dismiss).

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17 ⁴ In *Krinsk v. Fund Asset Mgmt., Inc.*, 715 F. Supp. 472, 501 (S.D.N.Y. 1988), for
18 example, the payments in question were to financial consultants retained to halt the
19 out-flow of assets to further promote sales rather than for routine maintenance
20 services, such as are involved here. *Meyer I*, 764 F.2d at 84-85, concerned sales
21 efforts to existing customers; the plaintiff attacked the uses to which the fees had
22 been put by the recipients rather than whether the fees were within the scope of the
23 rule itself. Indeed, the Second Circuit cautioned that "[w]e are not prepared to say
24 at this point that the possibility of additional share purchases makes payments for all
25 costs of shareholder servicing a distribution expense contemplated by the rule." *Id.*
26 at 85. Finally, *Gallus v. Ameriprise Fin., Inc.*, 497 F. Supp. 2d 974 (D. Minn.
27 2007), did not involve a categorical challenge under 12b-1 and, thus, did not address
28 its definitional scope, but, rather, undertook a conventional *Gartenberg* analysis.

⁵ NASD Rule 2830, relied on by defendants, addresses fee caps for broker-dealers
generally and does not specifically address Rule 12b-1, nor does it change the fact
that the rule is subject to the requirements of Rule 12b-1, which does not establish a
safe harbor from Section 36(b) liability. Release 16431 at 40 n.128.

1 **C. The Complaint's Allegations Are Adequate under *Gartenberg***

2 Even if the fees in question were not inherently barred by Rule 12b-1, they do
3 not meet the *Gartenberg* criteria and are excessive and disproportionate. The
4 “*Gartenberg* factors,” discussed in detail below, are: (1) the nature and quality of
5 the services provided by the advisers to the shareholders; (2) the profitability of the
6 mutual fund to the adviser-manager; (3) “fall-out” benefits; (4) the economies of
7 scale achieved by the mutual fund and whether such savings were passed on to the
8 shareholders; (5) comparative fee structures with other similar funds; and (6) the
9 independence and conscientiousness of the mutual fund’s outside directors. 694
10 F.2d at 928-29. Contrary to defendants’ insistence, the Complaint addresses all of
11 these factors expressly (or, in the case of fall-out benefits, in broad substance).

12 Defendants’ assertion that the Complaint contains essentially no factual
13 allegations whatsoever on the *Gartenberg* factors, but just conclusory statements, is
14 flatly incorrect. The facts detailed herein – the nature and quality of the services
15 provided to the Fund in relation to the statutory limits on financing and the legal
16 obligations of the broker-dealers; the *billions* of dollars in 12b-1 fees and advisory
17 fees paid to defendants; the size of the Fund (the eleventh largest in the nation), with
18 \$115 billion in assets (as of mid-2007), and the lack of economies of scale or of
19 economies that have been passed along to the Fund and its shareholders; the lack of
20 price competition with other funds; the failure of the Fund’s board of directors to
21 give material consideration to the annual reapproval requirement and to obtain price
22 concessions from broker-dealers concerning payments for commissions and
23 services, and, most tellingly, defendants’ admission that, to them, it is not relevant
24 whether economies of scale benefit the existing shareholders of the Fund – all
25 strongly support the conclusion that the motion to dismiss should be denied. This is
26 so because even if all of defendants financing activities are “primarily intended” to
27 sell Fund shares, the 12b-1 plans have benefitted only defendants by increasing their
28 advisory fees and have not produced any benefits for the Fund or its shareholders.

1 The factual detail set forth in the Complaint is more than adequate under
2 *Gartenberg*. The case law is clear that the short and plain statement of the claim
3 under Rule 8 does not require that each and every *Gartenberg* factor be addressed at
4 all, let alone addressed in detail. Indeed, defendants ignore that the *Gartenberg*
5 decision itself was the appeal of a judgment entered after a non-jury trial. 694 F.2d
6 at 925, 929-31. *E.g.*, *Wicks v. Putnam Inv. Mgmt., LLP*, 2005 U.S. Dist. LEXIS
7 4892, at *12-13 (D. Mass. Mar. 28, 2005) (“I agree with the plaintiffs that
8 *Gartenberg* -- should it be the appropriate standard--does not establish a heightened
9 pleading requirement for § 36(b) excessive fee claims”); *Pfeiffer*, 2004 U.S. Dist.
10 LEXIS 16924, at *15, *18, (it “is unnecessary for the plaintiff to set forth
11 evidentiary details to support this allegation, or to support those elements of the
12 *Gartenberg* test that may apply to promotion, distribution and service fees”);
13 *Millenco L.P. v. meVC Advisors, Inc.*, 2002 U.S. Dist. LEXIS 19512, at *9 n.3 (D.
14 Del. Aug. 21, 2002) (same); *see also Siemers*, 2006 U.S. Dist LEXIS 60858 at *51-
15 52; *Forsythe v. Sun Life Fin., Inc.*, 417 F. Supp. 2d 100, 113-6 (D. Mass. 2006).

16 **1. The Nature and Quality of the Services Provided**

17 As the Complaint alleges, for a substantial number of years, defendants have
18 charged the Fund and its shareholders hundreds of millions of dollars in both yearly
19 12b-1 and advisory fees. The Fund charges the maximum amount permitted by law
20 for shareholder services, whether pre-sale or post-sale – 0.25% – which is the same
21 percentage charged by a majority of funds. Compl. ¶¶ 73, 78, 181. This reflexive
22 adoption of the maximum fee permitted illustrates that despite the immense size of
23 the Fund and of the American Funds family overall, defendants did not seek to
24 obtain and did not obtain any benefits for the Fund and its shareholders, such as a
25 reduction in the amount paid to broker-dealers to finance services nor a limitation on
26 the types of activities that would be financed by the 12b-1 fees.

27 Defendants have admitted that a material portion of the Fund’s hundreds of
28 millions of dollars in 12b-1 fees paid to defendants are used to finance post-sale

1 shareholder services. Compl. ¶¶ 89, 100. But, this portion of the 12b-1 fee finances
2 activities that the broker-dealer was legally obligated to provide to account holders
3 at the broker-dealer's own expense. Compl. ¶¶ 10, 88, 90-91. The broker-dealer did
4 not have to be induced to provide that service in return for a payment.

5 All mutual funds are in the same position vis-à-vis a broker-dealer with
6 respect to provision of these services, meaning a broker-dealer would be legally
7 obligated to provide these services for all its clients who owned a mutual fund,
8 regardless of which mutual fund the client owned. There would be no reason for a
9 mutual fund to pay the broker-dealer for these services. Moreover, the average
10 account size for a fund in the American Fund family is \$25,000 and 60% of the
11 accounts are under \$10,000. Compl. ¶ 28. Common sense suggests that such small
12 accounts do not need substantial expenditures on shareholder services.

13 The Fund also charges the maximum 12b-1 fee for commissions, 0.75%, the
14 same percentage charged by most funds. Compl. ¶¶ 76-77. Similar to its
15 arrangement on shareholder services, defendants did not obtain from the broker-
16 dealers a limitation on commissions. *Id.* ¶¶ 177-82, 191.

17 Thus, defendants made no attempt to compete on the basis of fees. Instead,
18 defendants accepted the fees and coverage sought by the broker-dealers without
19 even attempting to negotiate a better deal for the Fund and its shareholders.
20 Complaint ¶¶ 178-79. *See Mutual Fund Fees: Additional Disclosure Could*
21 *Encourage Price Competition*, General Accounting Office, Rpt. No. GGD-00-126 at
22 62 (June 2000). Accordingly, under the express language of Rule 12b-1, there
23 cannot be "a reasonable likelihood that the [12b-1 fees] will benefit the [Fund] and
24 its shareholders" under these circumstances.

25 **2. The 12b-1 Fees Were More Than \$500 Million Over 3 Years**

26 In its fiscal year 2006, the 12b-1 fees paid by the Fund were approximately
27 \$195 million and the advisory fees paid were approximately \$251 million, for a total
28 for 2006 of approximately **\$446 million**. In its 2007 fiscal year, the 12b-1 fees paid

1 by the Fund were at least \$250 million and the advisory fees paid were
2 approximately \$348 million, for a total for 2007 of at least **\$598 million**. Although
3 complete figures were not available for its 2008 fiscal year at the time the action
4 was commenced, 12b-1 fees were also approximately in the \$225 – \$300 million
5 range and advisory fees were approximately \$438 million, for a total for 2008 of
6 more than **\$600 million**. Compl. ¶¶ 145-46, 152. Thus, in just the last three fiscal
7 years, the Fund paid more than **\$1.6 billion** combined in 12b-1 fees and advisory
8 fees, of which at least **\$645 million** was 12b-1 fees.

9 It is also noteworthy that in 2007 alone, the approximately 30 funds in the
10 American Funds family, the nation's second largest fund family, in total paid
11 defendants more than **\$2 billion** in 12b-1 fees (even though certain types of
12 expenses such as advertising (in some circumstances) and account maintenance are
13 not dependent on which particular American Fund mutual fund one owns). *See*
14 Compl. ¶¶ 7, 25, 99 n.7. Both on their face, and in conjunction with defendants'
15 failure to create or pass on economies of scale to the Fund and its shareholders,
16 these incredibly large amounts raise factual issues about whether the 12b-1 fees
17 were excessive and disproportionate.

18 **3. There Were No Economies of Scale, Material or Otherwise**

19 The 12b-1 fees did not create any economies of scale for the Fund from which
20 investors benefited. As a threshold matter, and regardless of the size of a fund,
21 economies of scale do not exist for investors in the mutual fund industry on 12b-1
22 fees, which are only a “dead-weight cost borne by both current and new
23 shareholders,” as numerous studies cited in the Complaint demonstrate. Compl. ¶¶
24 108-115, 134-37.

25 The lack of 12b-1 economies of scale for investors are exacerbated by the
26 sheer size of the Fund. As of mid-2007, the Fund was the 11th largest fund in the
27 United States, with assets of more than \$115 billion. Compl. ¶¶ 117, 149-50. Thus,
28 even if 12b-1 fees are not inherently a dead-weight cost borne by shareholders, and

1 economies of scale might exist, there are no economies of scale in a fund the size of
2 the Fund, as studies cited in the Complaint demonstrate. *Id.* ¶¶ 117-25. Moreover,
3 even if economies of scale were created for the Fund as it grew larger, no material
4 savings were passed on to the Fund and its shareholders. This is not surprising,
5 given that *Defendants have conceded publicly that it is not relevant whether*
6 *economies of scale benefit the existing shareholders of the Fund.* *Id.* ¶ 144.

7 For example, although defendants use breakpoints⁶ in calculating the advisory
8 fee, the breakpoint savings to the Fund were *de minimis* – only about \$7.6 million in
9 2007. In its fiscal year 2007 alone, the 12b-1 fees paid by the Fund to defendants
10 (or accrued against the Fund) were more than **\$250 million** and the advisory fee was
11 **\$348 million**, for a total of **\$598 million**. The breakpoint savings for the three years
12 ending with fiscal 2007 inclusive were less than \$24 million. In essentially the same
13 three year period, the 12b-1 fees paid by the Fund to defendants (or accrued) were at
14 least approximately **\$650 million** and the advisory fees were **\$799 million**, for a
15 total of more than **\$1.4 billion**. Compl. ¶¶ 145-52.

16 Assuming *arguendo* defendants passed along to the Fund the breakpoint
17 savings described above, the less than \$24 million in savings is immaterial as a
18 matter of law when compared to the approximately \$650 million in 12b-1 fees and
19 \$799 million in advisory fees paid by the Fund to defendants in just the last three
20 years. Thus, even if all activities financed by the plans herein are primarily intended
21 to result in the sale of fund shares, the 12b-1 plans have not produced material
22 economies of scale benefits for the Fund and its shareholders.⁷

23 _____
24 ⁶ The investment advisory fee is calculated as a percentage of the Net Assets
25 of the Fund. The percentage sliding scale contained “breakpoints,” which are
26 decreases in the marginal percentage charged for the investment advisory fee
as the Net Assets of the Fund increase. Compl. ¶ 149.

27 ⁷ Defendants turn the legal analysis on its head concerning the absence of
28 economies. Even assuming *arguendo* that defendants' partial fee waiver and
breakpoint analysis is applicable, if there are no economies of scale, then the Fund
(continued...)

1 **4. Comparing the Fund’s Fee Structure with that of Other Similar**
 2 **Funds Illustrates the Lack of Price Competition**

3 The Fund charged the maximum amount permitted by law for shareholder
 4 services, 0.25%, which is the same percentage charged by a majority of funds.
 5 Compl. ¶¶ 73, 78, 181. The same holds true for commissions, where the Fund
 6 charged the maximum 12b-1 fee, 0.75%. *Id.* ¶¶ 76-77. Similar pricing among
 7 competing mutual funds “does not support an inference that competition” exists and
 8 that the similar market price was reached through free and open competition.
 9 Instead, the lack of price competition suggests a lack of competition between
 10 advisers for fund business given the “unseverable relationship between the adviser-
 11 manager and the fund it services.” *Gartenberg*, 694 F.2d at 929 (“We disagree with
 12 the district court's suggestions that ... a fee is fair if it ‘is in harmony with the broad
 13 and prevailing market choice available to the investor.’ ... [T]he existence in most
 14 cases of an unseverable relationship between the adviser-manager and the fund it
 15 services tends to weaken the weight to be given to rates charged by advisers of other
 16 similar funds”). Compl. ¶¶ 178-79 (GAO Study).

17 **5. The Fund’s Directors Were Not Independent or Conscientious**

18 Nor did the Fund’s Board of Directors fulfill its responsibilities in overseeing,
 19 on a yearly basis, whether the Fund’s 12b-1 plans should be continued. After initial
 20 adoption, a 12b-1 plan must be reapproved yearly. In order to continue a plan, the
 21 Fund’s Board must conclude, “in light of their fiduciary duties under” Section 36(b)
 22 of the ICA, that “there is a reasonable likelihood that the plan will benefit the
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 (...continued)

25 and its shareholders paid \$250 million in 12b-1 fees in 2007; received no benefits in
 26 return for the \$250 million; and, given the increase in the size of the Fund, paid an
 27 increased net advisory fee (after any waiver) of \$349 million in 2007, which was
 28 \$97 million more than the 2006 net fee – for a net detriment to the Fund and its
 shareholders of hundreds of millions of dollars per year.

1 company [the Fund] and its shareholders.” Rule 12b-1(e), Compl. ¶ 71 n.2. The
2 SEC has identified nine “normally relevant” factors *infra* for a board to consider.

3 The Complaint makes the following detailed allegations about the Board’s
4 lack of independence and conscientiousness.

5 ● The Fund has a Board of Directors whose members have not
6 been elected by the shareholders in many years, who rarely meet, whose
7 focus is spread over many different funds in the American family of
8 funds, and who receive material compensation from the American
9 family of funds.

10 ● Each so-called independent Director of the Fund sits on
11 approximately four to five boards of directors of mutual funds within the
12 American Fund family and their respective Contracts Committees.

13 ● These common board members meet simultaneously as the
14 boards of those funds.

15 ● The Contracts Committee of the Fund held only one meeting
16 during the 2007 fiscal year, which was held simultaneously, or *seriatim*
17 on the same day, with the meetings of the Contracts Committees of the
18 other funds within the American family of funds.

19 ● Given that the Contracts Committee and/or the Board of the
20 Fund held only one meeting each during the 2007 fiscal year, which was
21 held simultaneously, or *seriatim* on the same day, with the meetings of
22 the Contracts Committees and/or the Boards of other funds within the
23 American family of funds, and assuming an eight hour workday, the
24 Contracts Committee of the Fund and/or the Board would have each
25 spent materially less than two hours total considering all of the Fund’s
26 many plans of distribution combined.

27 ● Given the number of Contracts Committees and Boards that,
28 respectively, were meeting during one day, the Contracts Committee

1 and Board of the Fund must have, during 2007 and prior years, spent an
2 immaterial amount of time considering the Fund's Plans of Distribution.

3 • In this limited amount of time, the Contracts Committee of the
4 Fund, as well as the Board of the Fund, could not possibly have
5 examined in any meaningful way, as required by their fiduciary duty,
6 the [nine] factors for continuing a 12b-1 Plan of Distribution, and were
7 limited simply to acting year after year as a rubber stamp for the
8 proposals of defendants regarding 12b-1 fees.

9 • Hence, the Fund's Contracts Committee and Board gave the
10 Fund's 12b-1 Plans only a perfunctory and not the careful consideration
11 required as to whether the plans should be continued.

12 • The very fact that the Fund's shareholders for a number of
13 years have been paying between \$80 million and \$250 million a year in
14 12b-1 fees, on top of paying approximately \$120 million to \$450 million
15 a year in investment advisory fees, while receiving a benefit of at most
16 \$7 million per year in advisory fee breakpoints, in itself demonstrates
17 the Board's failure to give the legally required consideration to its
18 annual approval for continuation of the Fund's 12b-1 Plans.

19 Compl. ¶¶ 165-68, 170-75. These allegations, taken as a whole, are sufficient for
20 pleading purposes under *Gartenberg*.⁸ See also ¶¶ 164, 177-82, 189, 191.

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22 ⁸ The cases cited by the defendants (Mem. at 21) are off point. *In re Morgan Stanley*
23 *& Van Kampen Mut. Fund Sec. Litig.*, No. 03 Civ. 8208 (RO), 2006 U.S. Dist.
24 LEXIS 20758 (S.D.N.Y. Apr. 14, 2006), concerned an Investment Advisor Act
25 claim. *Migdal v. Rowe Price-Fleming Int'l, Inc.*, 248 F.3d 321 (4th Cir. 2001), was
26 not a *Gartenberg* excessive fee claim but a direct claim against the directors as
27 interested persons. *Strougo v. Bea Assocs.*, 188 F. Supp. 2d 373 (S.D.N.Y. 2002),
28 was an ICA § 36(a) claim decided upon summary judgment. *Amron v. Morgan*
Stanley Inv. Advisors, Inc., 464 F.3d 338 (2d Cir. 2006), did not contain the
specificity of the allegations here.

1 **6. The SEC’s Rule 12b-1 Criteria Further Support the Complaint’s**
2 **Gartenberg Analysis**

3 In addition to the *Gartenberg* factors, the Complaint cites SEC criteria for
4 setting Rule 12b-1 fees that support plaintiff’s allegations. Rule 12b-1 itself
5 expressly refers to the SEC Release that published the rule as adopted, ICA Release
6 No. 11414, “for a discussion of factors which may be relevant to a decision to use
7 company assets for distribution.” Compl. ¶ 93.⁹

8 These SEC criteria provide further support to plaintiff’s *Gartenberg* analysis.
9 For example, it is clear, given the size of the Fund, that there is no “problem or
10 circumstance” making continuation of the plans “necessary or appropriate.” Criteria
11 Nos. 2-4. Compl. ¶¶ 95-101. Moreover, the hundreds of millions of dollars in 12b-
12 1 fees benefit only defendants, but not the Fund or its shareholders. Criteria Nos. 7-
13 8. For at least a number of years, the Fund’s 12b-1 plans have provided no or *de*
14 *minimis* benefits for the Fund and its shareholders. Criteria No. 9. Compl. ¶ 176.

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18 ⁹ The Release identifies the factors that it believes “provide helpful guidance to
19 directors” in pertinent part as follows: “(2) consider the nature of the problems or
20 circumstances which purportedly make implementation or continuation of such a
21 plan necessary or appropriate; (3) consider the causes of such problems or
22 circumstances and how it would be expected to resolve or alleviate them,
23 including the nature and approximate amount of the expenditures; the relationship of
24 such expenditures to the overall cost structure of the fund; the nature of the
25 anticipated benefits, and the time it would take for those benefits to be achieved; ...
26 (7) consider the possible benefits of the plan to any other person relative to those
27 expected to inure to the company; (8) consider the effect of the plan on existing
28 shareholders; and (9) consider, in the case of a decision on whether to continue a
plan, whether the plan has in fact produced the anticipated benefits for the company
and its shareholders.”

1 Here, the Complaint directly and extensively addresses five of the six
2 *Gartenberg* factors (all but the fall-out benefits) by name. The Complaint alleges
3 specific facts under each of the *Gartenberg* factors, although the headings do not
4 necessarily use *Gartenberg*'s literal words: (1) the nature and quality of the services
5 provided by the 12b-1 fees to the Fund and its shareholders. (Compl. ¶¶ 73-101,
6 177-82); (2) the profitability of the mutual fund to the defendants (Compl. ¶¶ 7-8,
7 73-78, 145-52); (3) the economies of scale achieved by the mutual fund and whether
8 such savings were passed on to the shareholders (Compl. ¶¶ 107-57); (4)
9 comparative fee structures with other similar funds (under the heading the Board's
10 failure to negotiate lower fees) (Compl. ¶¶ 73-78, 177-83); and (5) the independence
11 and conscientiousness of the mutual fund's outside directors (Compl. ¶¶ 40-58, 158-
12 76). *See also* Compl. ¶¶ 102-06 (interrelationship of the Plans and defendants' other
13 activities) (akin to fall-out benefits). Finally, unlike the CSAC, the Complaint
14 addresses the additional SEC criteria discussed in subsection 6.

15 All these facts, far more detailed than those in the CSAC, strongly support the
16 conclusion that the motion to dismiss should be denied.

17 **D. The Section 48(a) Claim Should Not Be Dismissed**

18 The Complaint also contains a claim under Section 48(a) of the ICA against
19 the parent management company, defendant CRMC, for what is in effect "control
20 person" liability. Section 48(a) states "It shall be unlawful for any person, directly
21 or indirectly, to cause to be done any act or thing through or by means of any other
22 person which it would be unlawful for such person to do under the provisions of this
23 title or any rule, regulation, or order thereunder." 15 U.S.C. § 80a-47(a). The
24 provision is akin to § 15 of the Securities Act of 1933 and § 20(a) of the Securities
25 Exchange Act of 1934 in that it makes control persons liable for primary violations
26 of underlying acts. As many courts have recognized, § 48(a) "is remedial and is to
27 be construed liberally." *See Strougo v. Scudder*, 964 F. Supp. 783, 806 (S.D.N.Y.

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1 1997), *dismissed on other grounds*, 27 F. Supp. 2d 442 (S.D.N.Y. 1998), *vacated in*
2 *part and remanded*, 282 F.3d 162 (2d Cir. 2002).

3 Defendants rely on an earlier decision by this Court in *Corbi*. However, there
4 is a contrary line of cases, which plaintiff respectfully submits should be followed
5 here, that hold that if the underlying claim alleging a primary violation is not
6 dismissed (here, §36(b)), then the 48(a) claim also is sustained.

7 The decisions defendants rely on apparently derive from the United States
8 Supreme Court's decision in *Alexander v. Sandoval*, 532 U.S. 275 (2001), which
9 held, in a different context, that there was no private right of action to enforce
10 regulations promulgated under Title VI of the Civil Rights Act of 1964. The issue
11 in these cases was the criteria for determining whether an implied private right of
12 action existed. These decisions did not address the question, presented here,
13 whether when a statute, Section 36(b) of the ICA, contains an express private right
14 of action with respect to a particular substantive provision of the ICA, and a
15 violation of a control parent section, Section 48(a), is predicated upon the Section
16 36(b) violation, should there be a private right of action under Section 48(a) against
17 the parent company. The court decisions cited in defendants' brief did not directly
18 address this issue (nor did this court in *Corbi*, as the *Corbi* plaintiffs acceded at oral
19 argument to the dismissal of that claim).

20 We respectfully disagree with the line of decisions that extend the *Alexander*
21 analysis to section 48(a). For example, most of the 48(a) decisions cited in
22 defendants' memorandum also discuss the court decisions holding that there are no
23 private rights of action under ICA Sections 34(b) and 36(a). Section 34(b) states
24 "[i]t shall be unlawful for any person to make any untrue statement of a material fact
25 in any registration statement," but does not expressly create a private right of action.
26 ICA section 36(a) expressly states that "[t]he Commission is authorized," but does
27 not identify any other permitted plaintiff. Concerning both of these sections, the
28 courts note that ICA Section 42 authorizes the SEC to enforce all provisions of the

1 ICA. Thus, Section 34(b) contains a substantive violation but does not expressly
2 create a private right of action to enforce it. Section 36(a) contains an injunctive
3 provision, but it is expressly limited to actions by the SEC. The difference between
4 these provisions and 36(b) is that unlike these sections, Section 36(b) expressly
5 creates a private right of action with respect to a substantive provision of the ICA
6 and the Section 48(a) claim is expressly predicated upon a violation of 36(b), and
7 merely adds additional persons who may be named as defendants in such a claim.

8 In other words, plaintiff believes that the best way to harmonize these cases is
9 to draw a distinction between (1) a plaintiff asserting a claim under an ICA section,
10 such as 34(b), that does not have an express private right of action, where there
11 would be no standalone private right of action under Section 48(a); and (2) a
12 plaintiff asserting a claim under § 36(b), where the Section 48(a) claim is predicated
13 on the express private right of action. Courts have sustained the latter such claim.
14 *In re Evergreen Mut. Funds Fee Litig.*, 423 F. Supp. 2d 249, 259-60 (S.D.N.Y.
15 2006); *In re Franklin Mut. Funds Fee Litig.*, 388 F. Supp. 2d 451, 469 (D.N.J.
16 2005); *In re Dreyfus Mut. Funds Fee Litig.*, 428 F. Supp. 2d 342, 356 (W.D. Pa.
17 2005), *judgment on the pleadings in defendants' favor on other grounds*, 428 F.
18 Supp. 2d 357 (W.D. Pa. 2006).

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IV. CONCLUSION

For the reasons set forth above, defendants’ motion to dismiss should be denied in its entirety.¹²

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Respectfully submitted,

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¹² If this Court should grant the dismissal motion, plaintiff intends to amend her complaint as of right under Rule 15(a) (1) of the Federal Rules of Civil Procedure.