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Securities Regulation Daily Wrap Up, INVESTMENT COMPANIES—D. Colo.: Plaintiffs’ counsel sanctioned up to $1.5M over failed Great-West fiduciary suit, (Sept. 30, 2020)

Securities Regulation Daily Wrap Up

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By John M. Jascob, J.D., LL.M.

Sanctions were warranted because the plaintiffs overlooked red flags raised about their expert's testimony on the damages allegedly caused by excessive mutual fund fees, the court ruled.

The federal district court in Denver has sanctioned plaintiffs’ counsel up to $1.5 million for recklessly pursuing claims that Great-West Capital Management breached its fiduciary duties to retirement plan investors by charging excessive advisory fees in violation of Investment Company Act Section 36(b). The attorneys were held personally liable for the defendants’ excess costs and fees under Judicial Code Section 1927 because they unreasonably multiplied the proceedings despite red flags concerning their expert’s testimony on damages. Once counsel took into account the flaws that the defendants had pointed out regarding the expert’s opinions, they should have recognized that they had no plausible means of establishing actual damages or "the outer bounds of arm’s length bargaining," which is the benchmark for a Section 36(b) violation, the court held (*Obeslo v. Great-West Capital Management, LLC*, September 28, 2020, Arguello, C.).

In a consolidated shareholder derivative action, individuals who acquired shares of certain Great-West-advised funds through their retirement plans had alleged that both the advisory and administrative services fees charged to the funds were excessive under Investment Company Act Section 36(b), which imposes on fund advisers a fiduciary duty with respect to the adviser’s compensation for services. After an 11-day bench trial, however, Judge Christine Arguello ruled that the plaintiffs failed to prove any of the *Gartenberg* factors for showing that the fees charged to the Great-West mutual funds were so disproportionately large that they bore no reasonable relationship to the adviser’s services and could not have been the product of arm’s length bargaining. Moreover, the plaintiffs failed to establish that they suffered actual damages, with the court characterizing the theories underlying their expert witness’s damages analysis as being "fundamentally flawed."

Red flags. The defendants then moved for sanctions under Judicial Code Section 1927, arguing that they should be compensated for the needless costs, expenses, and attorneys’ fees they incurred because the plaintiffs "used valuable trial time as merely the last stage in an effort to prosecute damages theories with no legal validity." The court agreed, noting that the defendants’ motion for summary judgment had pointed out that some of the theories of the plaintiffs’ expert regarding damages were in conflict with non-binding, but well-established, caselaw and the legislative history of the Investment Company Act.

Moreover, while denying the defendants’ separate motion to strike the plaintiffs’ expert under Federal Rule of Civil Procedure 702, the court itself had observed that caselaw suggested that some of the expert’s opinions were factually inaccurate. In spite of the red flags raised by the defendants and the court regarding the expert’s opinions, the plaintiffs proceeded to trial, relying on the expert as the sole means of calculating the amount of damages they allegedly suffered. At trial, the expert’s "complete lack of credibility" regarding the element of damages "dealt a fatal blow" to the plaintiffs’ case, the court stated.

Sanctions under Section 1927 were warranted, therefore, because the plaintiffs’ counsel recklessly pursued their claims through trial despite the fact that they were lacking in merit. As the plaintiffs themselves recognized in their own motion for sanctions, "no plaintiff who has pursued a claim under §36(b) of the Investment Company Act has ever won in the 50 years of that section’s existence." Given this uphill battle, once the flaws in their expert’s theories had been pointed out, plaintiffs’ counsel should have should have understood that they had no

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plausible means of establishing actual damages or "the outer bounds of arm's length bargaining," as required under the statute.

Even apart from the attorneys' failure to appreciate the depth of the flaws in the expert's opinions, sanctions under Section 1927 would still be warranted, the court reasoned, because the defendants presented evidence that overwhelmingly showed that their fees were reasonable and that they did not breach their fiduciary duties. In the court's view, the prudent course for the plaintiffs would have been to voluntarily dismiss the case, especially given that no plaintiff has ever prevailed on a Section 36(b) claim. "Proceeding to trial under those circumstances was, therefore, objectively reckless," the court concluded.

The case is No. 16-cv-00230.

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Companies: Great-West Capital Management, LLC

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