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## Supreme Court Endorses *Gartenberg*, but it's not the Same Old Standard

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In May 2008, in a case called *Jones v. Harris*, the US Court of Appeals for the Seventh Circuit created significant uncertainty as to the legal obligations of investment company boards in approving investment advisory agreements for funds registered under the Investment Company Act of 1940.

After 25 years of virtual consensus regarding the factors detailed in *Gartenberg v. Merrill Lynch Asset Management*, the Seventh Circuit concluded that an investment adviser has not violated Section 36(b) of the 1940 Act—which creates a private right of action for breach of “fiduciary duty with respect to the receipt of compensation for services” paid by the investment company to the adviser or its affiliates—unless an adviser “pulled the wool over the eyes of the disinterested trustees or otherwise hindered their ability to negotiate a favorable price for advisory services.”

Now, a unanimous US Supreme Court has rejected the Seventh Circuit’s pulled-the-wool standard under Section 36(b) and held that the *Gartenberg* formulation was correct: namely, liability under Section 36(b) requires that “an investment adviser must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm’s length bargaining.”

“The Supreme Court has restored much needed stability to the process by which boards review compensation for services to investment advisers and their affiliates,” says WilmerHale Partner [Lori A. Martin](#), a member of the Investment Management and Securities Litigation and Enforcement Practice Groups, and the Business Trial Group. “The *Jones v. Harris* decision has restored the sensible framework created in *Gartenberg*, which focuses on the nature and quality of services provided by the adviser, as well as the range of fees that would be negotiated by arm’s-length bargaining. The Supreme Court’s articulation of the *Gartenberg* standard nonetheless comes with some new twists.”

Read the full text of a recent WilmerHale Email Alert on this subject: [Supreme Court Endorses \*Gartenberg\*, but it's not the Same Old Standard](#).

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