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Comment, Settlement Standards for Mutual Fund Shareholder Litigation Involving the Fiduciary Obligation to Recapture

James J. Shirley

SETTLEMENT STANDARDS FOR MUTUAL FUND SHAREHOLDER LITIGATION INVOLVING THE FIDUCIARY OBLIGATION TO RECAPTURE

Mutual fund shareholders are currently attacking, in shareholders' derivative actions, a practice common among fund investment advisers; their complaints allege that an adviser's failure to recapture certain brokerage commissions paid by the fund constitutes a breach of fiduciary duty both by the adviser and by the fund directors who permitted the practice.[1] The plaintiff shareholders argue that the commissions, if recaptured, could have been credited by the investment adviser against the management fees owed to him by the fund;[2] failure to recapture, then, has resulted in payment of excessive management fees by the fund.

Most of the suits now pending before the courts will probably be resolved in out-of-court settlements. Not only do all the parties want to avoid the time and expense required by the litigation, but a recent decision, *Moses v. Burgin*,[3] appears so favorable to the shareholders' claims that the defendants will presumably seek settlements rather than risk trials on the merits. However, such settlements cannot be made without judicial approval of the proposed terms of agreement.[4] This requirement is imposed in derivative suits for the protection of the many parties in interest—the shareholders—who are not before the court.[5] Accordingly, the proponents of each settlement will have to prove that its terms meet certain standards.[6]

The problem, then, is to determine precisely what the standards of a fair settlement should be. Traditionally, the courts have required that the settlement be "fair and adequate."[7] This requirement, however, appears to offer only a vague and elusive guide for evaluating the settlement of suits involving issues as sophisticated as those entailed in the recapture actions. Unfortunately, the courts have found it difficult to articulate specific standards by which to gauge "fairness and adequacy."

Past settlements appear to have been measured by judicial speculation as to the degree of success each party would have obtained had the dispute gone to trial.[8] The probability of success is usually determined at a hearing in which all interested parties are invited to

1 See Moses v. Burgin, 445 F.2d 369, 372 (1st Cir. 1971); Kurach v. Weisman, 49 F.R.D. 304, 306 (S.D.N.Y. 1970).

2 445 F.2d at 369.

3 445 F.2d 369 (1st Cir. 1971).

4 Fed. R. Civ. P. 23, 23.1; Haudek, The Settlement and Dismissal of Stockholders' Actions—Part II: The Settlement, 23 Sw. L.J. 765, 792 (1969) [hereinafter cited as Haudek].

5 Id. at 792-93.

6 See Norman v. McKee, 431 F.2d 769, 774 (9th Cir. 1970).

7 Id. at 774.

8 See Florida Trailer & Equip. Co. v. Deal, 284 F.2d 567, 571 (5th Cir. 1960).

appear.[9] Having determined the likelihood of each party's success, were the action to be tried, the court usually relies on that determination as the single most important factor in evaluating the settlement.[10]

In making such determinations, however, the courts have developed no precise canons. Rather, since the plaintiffs have traditionally enjoyed relatively little likelihood of success,[11] the probability standard has in reality been so lenient a measure that courts have approved almost any settlement agreed upon by the parties. This pattern is the result of earlier litigation, wherein shareholders had specifically alleged that mutual funds were paying excessive management fees.[12] In view of the uniformity of such fees throughout the fund industry, the courts had declined to uphold the shareholders' contention, and a majority of the management fee cases had been settled by the shareholders on the ground that their chances of recovery were too speculative. The impact of this earlier litigation had a profound effect on the subsequent recapture cases and sustained the probability of success in favor of management.

It is submitted that *Moses v. Burgin* will reduce or even eliminate the impact of the early cases. The *Moses* court's interpretation of the duty to seek recapture in certain situations has pumped new content into the probability standard, enabling it to serve as a meaningful measure by which to evaluate the settlement agreements of the currently pending suits. It is also submitted that a second standard, an appropriate measure of damages, should be applied by the courts. Until recently, the plaintiffs' weak position obviated any need for precise consideration of a settlement's fairness vis-à-vis the plaintiff's damages.[13] Now, however, the courts should evaluate the pending settlements in terms of damages as well as the probability of success standard. *Moses v. Burgin* not only develops a doctrine that would give the plaintiff a relatively high probability of success, but also offers suggestions, though not definite guidelines, for determining an appropriate measure of damages in a shareholders' suit alleging failure to recapture.

After a preliminary survey of the development of recapture theory, this comment will examine the impact that the duty, probability and damages doctrines developed or suggested in *Moses* may be expected to have on the settlement of the pending derivative suits. The fairness and adequacy of settlement offers will then be examined in

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[9] Haudek, supra note 4, at 801-06.

[10] See 284 F.2d at 571.

[11] See Meiselman v. Eberstadt, 39 Del. Ch. 563, 170 A.2d 720 (1961); Saxe v. Brady, 40 Del. Ch. 474, 184 A.2d 602 (1962); Acampora v. Birkland, 220 F. Supp. 527 (D. Colo. 1963).

[12] E.g., Saminsky v. Abbott, 41 Del. Ch. 320, 327, 194 A.2d 549, 552 (1963), aff'd sub nom. Kleinman v. Saminsky, 200 A.2d 572 (Del. Sup. Ct., 1964), cert. denied, 379 U.S. 900 (1964).

[13] Id.

terms of both the probability of the plaintiffs' success, were the action to come to trial, and their damages as measured by the *Moses* standard.

I. THE DUTY TO RECAPTURE AND THE PROBABILITY OF SUCCESS STANDARD

A. *From Give-ups to the First Suggestions of a Duty to Recapture*

Since a mutual fund adviser's management fees are based on a percentage of the fund's net assets,[14] fund advisers realize added fees from increased sales of fund shares. Until recently, advisers frequently stimulated the sale of shares by two devices, commonly called give-ups and reciprocals. The advisers would direct the brokers who executed fund share transactions to surrender to other brokers a portion of their commissions on such transactions—give-ups[15]—or to transfer to them sufficient unrelated brokerage business to result in equivalent commission income—reciprocals.[16] The brokers who received the give-ups or reciprocals would respond by promoting and transacting sales of fund shares, which resulted in larger net assets and hence larger fees for the advisers.[17] The brokers who gave up their commissions according to the directions of the adviser were willing to do so in order to compete successfully for the opportunity of transacting fund portfolio business, which yielded enormous brokerage commissions, far in excess of the actual costs of executing the transactions.[18] These enormous commissions were in turn attributable to the fixed minimum rate structure within the securities industry[19] and to the fact that volume discounts

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14 Miller & Carlson, Recapture of Brokerage Commissions by Mutual Funds, 46 N.Y.U. L. Rev. 35, 42 (1971) [hereinafter cited as Miller & Carlson].

15 Id. at 31 n.2. There are instances, where a dealer *may* give up part of his commission to another broker who has handled a portion of the transaction. In that situation, there has been an actual sharing of the efforts involved in executing the trade and the resulting fee-splitting seems to pose little regulatory problem. Report of the SEC on the Public Policy Implications of Investment Company Growth, H.R. Rep. No. 2337, 89th Cong., 2d Sess. 169-70 (1966) [hereinafter cited as PPI].

16 Miller & Carlson, supra note 14, at 36 n.6.

17 PPI, supra note 15, at 180.

18 Comment, The Use of Brokerage Commissions to Promote Mutual Fund Sales: Time to Give Up the "Give-Up", 68 Colum. L. Rev. 334, 336 (1968). Because of give-ups and reciprocals the actual commission charged on a transaction may be divided among several brokers, most of whom had nothing to do with the deal. The SEC felt that such practices led to increased competition among stock brokers and observed that:

> [C]ompetition in the securities industry between institutional managers and brokers and between exchanges, has operated to reduce very substantially the amount of commissions actually *retained* by executing brokers—but with relatively little impact or effect as yet on the commissions actually *paid* by the public investors who invest through institutional media.

SEC Securities Exchange Act Release No. 8239 [1967-1969 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 77,523 at 83,082.

19 Miller & Carlson, supra note 14, at 37-38. This rate structure requires the imposition of a fixed minimum brokerage commission on all orders having a value of $500,000 or less. For that portion of each order which exceeds $500,000, negotiated rates are permitted. SEC Policy Statement, Future Structure of the Securities Markets 28 (Feb.

were not permitted on the nation's stock exchanges.[20] Thus the practice of awarding give-ups and reciprocals was derived from the minimum rate structure and the absence of volume discounts within the securities industry, factors which permitted brokers to collect excessively large commissions on fund portfolio transactions.

The practice of awarding give-ups continued unquestioned until 1966, when the Securities and Exchange Commission (SEC) suggested that the excess commissions might be used to reduce a fund's expenses.[21] The SEC pointed out that give-ups could be recaptured by the adviser and credited against his management fee.[22] At first glance, the Commission's suggestion seemed to run counter to the anti-rebate rules[23] of the various stock exchanges. However, the SEC stated that:

> It would not be inconsistent with those rules [of regional exchanges] for dealer-distributed funds to direct give-ups to their adviser-underwriters, all of whom are [National Association of Securities Dealers] members, for the purpose of applying these give-ups to reduce the advisory fees payable by the funds.[24]

Moreover, the SEC noted, several funds had already begun some type of recapture on one or more of the regional stock exchanges.[25] Although the Commission's suggestion never became an official mandate, the practice of recapturing commissions came to be unofficially tolerated on many regional exchanges.[26]

1972). The SEC recently announced that no later than April, 1972, the negotiated rate level will be reduced to $300,000. Id. at 33.

[20] Miller & Carlson, supra note 14, at 37. As the term implies, "volume discounts" refers to the practice whereby brokerage commission rates are reduced in proportion to the increase in the size of fund portfolio transactions. Since this practice is presently not tolerated on orders below $500,000 because of the fixed minimum commission rate schedule, brokerage costs are significantly unrelated to the size of a transaction. Id.

[21] PPI, supra note 15 at 173.

[22] Id. at 173.

[23] These rules prohibit brokers from giving direct commission refunds to customers. A typical provision is the rule set forth in the New York Stock Exchange (NYSE) constitution:

> Commissions shall be charged and collected upon the execution of all orders for the purchase or sale for the account of members or allied members or of parties not members or allied members of the Exchange, of securities admitted to dealings upon the Exchange and these commissions shall be at rates not less than the rates in this Article prescribed; and shall be net and free from any rebate, return, discount or allowance made in any shape or manner, or by any method or arrangement direct or indirect.

NYSE Const., art. XV § 1, as reprinted in Moses v. Burgin, 316 F. Supp. 31, 40 (D. Mass. 1970). The anti-rebate rules of other stock exchanges listed by the district court in Moses are: Boston Exchange Const., art. XVIII, §§ 1-4; Detroit Exchange Const., art. XVIII, §§ 1-4; Midwest Stock Exchange Rules, art. XXIX, §§ 1-21; Pacific Coast Stock Exchange Const., art. XIV, §§ 1-8; Philadelphia-Baltimore-Washington Exchange Const., art. XX, §§ 1-9. Id.

[24] PPI, supra note 15, at 173.

[25] Id. at 172-73.

[26] Stock exchanges presently allowing recapture include the Philadelphia-Baltimore-

B. *Methods of Recapture*

The mutual fund industry developed two methods of effecting recapture. One involved the placing of portfolio brokerage with a broker affiliated with the mutual fund, such as an underwriter, rather than with an independent firm.[27] By placing portfolio transactions with its affiliated underwriter, the fund achieved direct recapture, recovering on its brokerage expenses by participating in the profits of the subsidiary broker.[28] The second method of recapture involved using a broker-affiliate of the management adviser. The adviser would direct much of the fund's brokerage business and any give-ups due from other brokers to the subsidiary broker-dealer, whose profits would then be credited against the adviser's management fee or taken into account by the adviser in fixing his management fee.[29]

Unfortunately, notwithstanding the benefits that recapture afforded to funds and fund shareholders by reducing management expenses, many members of the mutual fund industry failed to adopt either method of recapture. This failure aroused the ire of knowledgeable shareholders who, already concerned about what they regarded as the exorbitant compensation paid to fund investment advisers, instituted numerous derivative suits against fund directors and advisers, alleging that the failure to recapture commissions constituted a breach of fiduciary duty.[30]

C. *Development of a Duty to Recapture Doctrine and a New Probability Standard*

This history of unfavorable settlements proved to be a disadvantage to the plaintiffs bringing recapture suits, which in essence were a new form of attack on management fees. The courts, applying the likelihood of success test, found the plaintiffs' position weak and approved concomitantly weak settlements. *Kurach v. Weissman*[31] illustrates how application of the probability of success test, combined with precedent apparently unfavorable to their cause, frustrated the plain-

Washington, Midwest, Pacific Coast and Boston Stock Exchanges. The Cincinnati Stock Exchange does not have any institutionally affiliated brokers through whom recapture might be effected; however, the Exchange's rules do not prohibit the membership of such brokers. Wall Street Journal, March 2, 1972, at 2, cols. 3-4.

27 Glazer, A Study of Mutual Fund Complexes, 119 U. Pa. L. Rev. 205, 243 (1970) [hereinafter cited as Glazer].

28 Id.

29 Id. at 243-44. It should be noted that customer-directed give-ups were tolerated until abolished on December 5, 1968. Although the SEC had drafted a proposal to end give-ups, the Commission did not promulgate the rule which finally abolished them. The SEC's Rule 10b-10 was not enacted into law because the various stock exchanges eliminated the use of customer-directed give-ups on their own. See SEC Release No. 8239, 33 Fed. Reg. 2393 (1968).

30 It is estimated that more than 50 lawsuits challenging this failure to recapture are presently pending before the courts. See Brief for Defendants at 11-12, Gross v. Moses, 71 Civ. 2162 (S.D.N.Y., filed Aug. 13, 1971).

31 49 F.R.D. 304 (S.D.N.Y. 1970).

tiffs' attempt to win a strong settlement. In *Kurach*, a shareholders' derivative suit against the Dreyfus Fund and the fund's management company, the shareholders alleged that the management fee of one-half of one percent of the net assets of the fund was excessive because a portion of the commissions of the adviser's broker-affiliate could have been recaptured and applied against the fee.[32] Relying on earlier management fee cases,[33] the court found that the plaintiffs' likelihood of success did not appear strong. Hence it approved the defendants' settlement offer to effect future recapture and to credit, over a five-year period, one million dollars of returns from recapture against the fund's management fee obligation. The token offer, "modest as it may appear to be,"[34] was deemed a reasonable disposition of the action.

The court found no duty to recapture. It took the position that the investment adviser's broker-affiliate was not obligated to turn brokerage profits over to the fund and that the adviser was not required to credit the profits against his management fee.[35] The court derived this determination from its interpretation of Section 17(e) of the Investment Company Act of 1940,[36] which authorizes fund advisers to receive, subject to express limitations, commissions from their broker-affiliates in connection with fund portfolio transactions.[37] The court determined that the statute's authorization of the adviser's right to receive commissions included implicit authorization of his right to retain those commissions;[38] accordingly, section 17(e) appeared to rebut the plaintiffs' assertions that the adviser should have applied brokerage profits to reduce his fee. Hence the court found that the defendants' offer to enter into future recapture and reduce the management fee by $1,000,000 over a five-year period would result in a fair and reasonable settlement.

The SEC opposed the settlement offer on the grounds that the agreement was illusory and gave to the shareholders only what they were already entitled to at law.[39] The SEC based its contention on the fact that many of the commissions acquired by the broker-affiliate were give-ups and reciprocals and hence should not have been retained

32 Id. at 305.

33 See note 11 supra. The courts generally have felt powerless to intervene in this area of the mutual fund industry—except in cases where the fee is "wasteful," "unconscionable," or "shocking." PPI, supra note 15, at 142. Based on the fact that investment companies' advisory fees are approved annually by a majority of the unaffiliated directors, subject to ratification by the stockholders, the courts declined to hold such fees excessive. Moreover, shareholder ratification shifts the standard for determining fairness of an investment adviser's fee from one of fairness to one of waste. No court was willing to hold such fees excessive or wasteful where the advisory contract secured shareholder approval. See Glazer, supra note 27, at 260-61.

34 49 F.R.D. at 307.

35 Id.

36 15 U.S.C. § 80a-17(e) (1970).

37 These statutory limitations have been imposed to prevent brokerage commissions from exceeding a certain level. Miller & Carlson, supra note 14, at 44 n.50.

38 49 F.R.D. at 307.

39 Id.

by the broker. The Commission argued that the profits derived from these sources were not earned as a result of the performance of any services for the fund, and accordingly should have been credited against management fees payable by the fund to the adviser.

However, the court neither accepted this argument nor examined all of the facts germane to the issue of recapture. Rather, the court was satisfied that prior management fee decisions, which indicated that the defendants probably would have been successful at trial, obviated the need for further consideration of recapture.[40] Then, having ascertained a probability of success on the part of the defendants, the court appeared willing to approve any settlement offer agreeable to both parties. It is submitted that such an approach, which virtually foreclosed any opportunity for the plaintiffs to develop grounds for a favorable settlement, provided little or no protection for those shareholders who could not examine the settlement proposal. Indeed, it could be argued that the court's summary approval of the token settlement constituted an abrogation of its responsibility as guardian of the shareholders' interests.

However, after the *Kurach* settlement had been approved, the SEC issued an administrative ruling that clearly articulated the argument which the Commission had originally postulated in *Kurach* and squarely opposed the *Kurach* court's interpretation of section 17(e). In *Provident Management Corp.*,[41] a fund's investment adviser received and retained reciprocal commissions from its broker-affiliate, which had received the reciprocals in the first place from brokers to whom the adviser had allotted fund portfolio transactions. The SEC, relying on Section 17(e) of the Investment Company Act, reasoned that "a fund affiliate which has in fact entered into reciprocal arrangements whereby it recaptured a portion of fund brokerage cannot, consistent with its fiduciary obligations to the fund, retain for itself the benefits derived."[42] Section 17(e) declares that it is unlawful for any person affiliated with a registered investment company and "acting as [its] agent, to accept from any source any compensation . . . for the purchase or sale of any property to or for such registered [investment] company . . . except in the course of such person's business *as* [*a*] . . . *broker*. . . ."[43] The Commission ruled that the phrase "acting as a broker" required the broker-affiliate to perform some type of service or function with regard to the transaction that gave rise to the commission.[44]

In an amicus curiae brief opposing a settlement in a later case, the Commission developed this interpretation of Section 17(e):

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[40] Id.

[41] SEC Securities Act Release No. 5115 (Dec. 1, 1970), [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 77,937, at 80,083.

[42] Id. at 80,087 n.14.

[43] 15 U.S.C. § 80a-17(e) (1970) (emphasis added).

[44] SEC Securities Act Release No. 5115 (Dec. 1, 1970), [1970-1971 Transfer Binder] CCH Fed. Sec. Rep. ¶ 77,937, at 80,088.

> Of course, a brokerage affiliate of the investment adviser does not perform any brokerage services, and is thus not acting as a "broker," when it receives reciprocals. The reciprocals are paid to the affiliate simply because the affiliate's parent, the adviser, has the power to direct or has directed the fund's portfolio transactions to the reciprocating broker.[45]

However, despite the clear support given to the shareholders' position by the SEC's recapture doctrine, the Commission's ruling in *Provident Management* was not a judicial determination on which plaintiffs could rely. Hence *Provident Management* did not represent a decisive shift in favor of plaintiff-shareholders' probability of success in recapture litigation. Nevertheless, the ruling weakened the favorable position enjoyed by defendants in such litigation and had a corrosive effect on *Kurach* and similar approvals of settlements favorable to defendants.

D. *Moses v. Burgin*

The implications of *Provident Management* were realized in *Moses v. Burgin*,[46] in which the First Circuit provided the first thorough judicial examination of recapture and its associated issues. In *Moses*, the defendants—the investment adviser, the adviser's underwriter and certain directors of a mutual fund—endorsed a policy to promote sales of fund shares by awarding give-ups to brokers who had sold such shares to the public. The defendants committed the fund to this policy notwithstanding the fact that representatives of the SEC and an SEC report,[47] published in 1966, had suggested that it might be advantageous for the fund to recapture the fund's give-ups. Moreover, the defendants had failed to inform the fund's unaffiliated, or "watch-dog," directors[48] of the possibility of recapture. Rather, the court later found, the defendants had actively concealed this information from those directors even though the possibility of recapture entailed a potential conflict between the management company's interests and the interests of the fund's shareholders.[49]

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[45] Brief for Defendants, Gross v. Moses, supra note 30, at 12.

[46] 445 F.2d 369 (1st Cir. 1971).

[47] PPI, supra note 15 at 173.

[48] These unaffiliated directors have been defined as follows:

> The principal safeguard provided by [Section 10(a) of] the Investment Company Act, against overreaching by managers or advisers, is the so-called unaffiliated director [of a mutual fund] which means in plain English a presumably independent director, which in turn means that he is supposed to safe-guard the public—he's a watchdog—against the human tendency of management to take as much as they can get away with, short of being caught by us cops, or triggers, [sic] or the SEC or someone else. . . . Who picks the unaffiliated directors? The affiliated men pick the unaffiliated men. The men who need to be watched pick the watchdogs to watch them.

Comment, The Mutual Fund Management Fee, 115 U. Pa. L. Rev. 726, 739 (1967).

[49] The court noted that this potential conflict was based on the fact "that the principal beneficiaries of fund-paid portfolio commissions are not the funds, but the advisers and underwriters." 445 F.2d at 377. Thus, any reductions in these commissions by

In response to this situation, shareholders brought a derivative action alleging that the defendants had violated their fiduciary duties as imposed by the Investment Company Act of 1940[50] and the common law. More specifically, the plaintiffs claimed that the adviser's failure to recapture a portion of the brokerage paid on fund portfolio transactions constituted a gross abuse of trust under Section 36 of the Act.[51] The shareholders also argued that since the management adviser's fee was based on a percentage of the fund's net assets, the adviser's use of give-ups to reward brokers for increased sales of fund shares benefited the adviser to the detriment of the fund's investors. The defendants replied that even if recapture were in fact a practical possibility, the directors still had a right to choose between recapturing the give-ups for the fund's direct benefit and awarding them to brokers for its indirect benefit; in short, that the decision lay within the area of discretion committed to the directors' business judgment.

The court dismissed the defendants' argument, ruling that where recapture was freely available, the directors had no choice but to utilize recapture for the benefit of the fund. The court reasoned that:

> If Fund receives the asset value of new shares, but at the same time rewards the selling broker with give-ups that it has a right to recapture for itself, then the net income Fund receives from the process of selling a share is less than asset value. The existing shareholders have contributed—by paying more than otherwise necessary on Fund's portfolio trans-

means of recapture would benefit the fund; conversely, any failure to recapture would benefit the adviser.

50 15 U.S.C. §§ 80a-1 et seq. (1970).

51 Investment Company Act of 1940 § 36, ch. 686, § 36, 54 Stat. 841. This section authorized the SEC to obtain injunctive relief against the officers, directors, adviser and principal underwriter of a mutual fund if they have "been guilty . . . of gross misconduct or gross abuse of trust in respect of" the fund. Although § 36 allowed the SEC to bring suit for management breaches of fiduciary duty, it neglected to state whether a shareholder was authorized to bring such an action. Even so, some courts interpreted the section as permitting shareholder suits. The amended version of § 36 clearly authorizes such suits and treats a fund's investment adviser as a fiduciary with respect to management compensation. The new provision states:

> For the purposes of this subsection, 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, or of payments of a material nature, paid by such registered investment company, or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser. An action may be brought under this subsection by the Commission, or by a security holder of such registered investment company on behalf of such company, against such investment adviser, or any affiliated person of such investment adviser, or any other person enumerated in subsection (a) of this section who has a fiduciary duty concerning such compensation or payments, for breach of fiduciary duty in respect of such compensation or payments paid by such registered investment company or by the security holders thereof to such investment adviser or person.

15 U.S.C. § 80a-35(b) .(1970).

> actions—to the cost of the sale, which was supposed to have been borne by the new member alone.[52]

Hence *Moses* would require a fund's investment management adviser to credit against the fund's management fee the commissions obtained on fund brokerage by a broker affiliate of the fund or the adviser, where such commissions are recovered by the adviser.

On the other hand, *Moses* does not go so far as to require a fund's directors to *create* an affiliated broker in order to effect recapture. In fact, the *Moses* court agreed with the defendants when it stated that "sound business reasons"[53] might militate against switching from independent to affiliated brokers. When questioned on this precise issue, the SEC agreed with the court's position:

> You ask first whether mutual fund management has a fiduciary duty to acquire a stock-exchange seat, directly or through an affiliate, in order to utilize this means to recapture brokerage which in turn will be offset against management charges. We do not believe that management has this duty if in the exercise of its best business judgment management determines that it is not in the best interest of the fund to create such an affiliate.[54]

In short, then, the *Moses* court held that while a fund's management adviser has no absolute fiduciary duty to acquire a broker-affiliate in order to effect recapture, but rather may exercise its business judgment in the matter, such a duty does exist where there is an existing affiliation.

Moses established a legal duty to recapture, in certain circumstances, and so increased significantly the shareholders' probability of success in the pending recapture litigation. Hence the defendants in these suits will be more inclined to offer, and the courts more inclined to require, settlements that reflect the favorable position enjoyed by shareholder-plaintiffs since the First Circuit decided *Moses*.

E. *Pending Litigation: The Impact of* Moses *and* Provident Management *on the Duty to Recapture and the Plaintiffs' Probability of Success*

Over fifty shareholder derivative suits with fact situations similar to that in *Moses* are presently pending before the courts[55] and many are awaiting approval of their settlement offers. Two pending derivative actions recently consolidated, *Gross v. Moses*[56] and *Edelman v.*

[52] 445 F.2d at 374.

[53] Id. at 375.

[54] SEC Securities Exchange Act Release No. 8746 (Nov. 10, 1969), [1969-1970 Transfer Binder] CCH Fed. Sec. Rep. ¶ 77,761 at 83,747.

[55] See note 30 supra.

[56] 67 Civ. 4186 (S.D.N.Y., filed Aug. 13, 1971).

Brown,[57] were brought on behalf of funds managed by Massachusetts Financial Services, Inc., an investment advisory company. The plaintiffs in this consolidated action, as in the other recapture cases, had charged the management company with failing to recapture portfolio brokerage commissions for their respective funds. The defendants have offered to reduce the management fee by entering into recapture. The investment adviser agreed to seek membership on certain regional exchanges that allow members to enter into recapture and so permit a portion of the "net profits" derived from fund brokerage transactions to be credited against the advisory fee.[58] The management company further guaranteed recapture of a minimum amount over a period of ten years.[59]

However, the SEC is opposing the settlement proposed by the *Gross* and *Edelman* defendants,[60] claiming that the agreements are illusory. More specifically, it is argued that the agreements provide no benefits to the mutual funds or their shareholders since less than conformance to applicable law is required,[61] and no consideration for past violations is provided.[62] The thrust of the SEC's argument seems to be that once the management company has decided to recapture brokerage for the fund, it cannot impose a limit, absent approval by the fund, on the length of time during which recaptured commissions will be applied against the advisory fee. The Commission stressed that this position was supported by *Moses* and *Provident Management*, which required management defendants to credit the investment fee with recaptured brokerage until such time as the fund's directors determined that recapture was no longer in the best interests of the fund and its shareholders.[63] The *Moses* court held that where recapture is freely available to a fund, the defendants have no choice as to whether such brokerage will be used for the fund's benefit or for that of the management company. Defendants are under a duty to utilize recaptured commissions for the fund's direct benefit.

However, in *Gross* and *Edelman* recapture had not been "freely available" prior to the suit, as it had been in the *Moses* situation. Neither the adviser nor the fund, in *Gross* and *Edelman*, have an existing broker-affiliate. Rather, the adviser has now offered, as part of a settlement agreement, to seek membership on stock exchanges.[64] Hence *Gross* and *Edelman* raise the question as to whether the *Moses* duty to recapture applies to situations where the adviser voluntarily

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[57] 71 Civ. 2162 (S.D.N.Y., filed Aug. 13, 1971).

[58] Brief for Defendants, Gross v. Moses, supra note 30, at 5.

[59] Defendants agreed to recapture a minimum of $1,500,000 over a 10 year period. Id. at 6.

[60] Brief for SEC as Amicus Curiae, Gross v. Moses, 67 Civ. 4186 (S.D.N.Y., filed Aug. 13, 1971) [hereinafter cited as SEC Brief].

[61] Id. at 8-16.

[62] Id. at 17-18.

[63] Id. at 11-12.

[64] See Brief for Defendants, Gross v. Moses, supra note 30, at 5.

assumes the obligation as part of a settlement to end a shareholder suit. *Moses* would seem to support such an obligation, since the court found that such a duty existed where it was at all practicable for an investment adviser to effect recapture.[65] It would seem reasonable to assume that if recapture is undertaken voluntarily by the adviser, even as a result of the settlement of a legal dispute, then it is practicable to effect; hence, a continuing duty to effect recapture should arise from that undertaking. Moreover, since most courts will not second-guess the judgment of directors in business decisions, but will decide "whether a reasonable board could have reached"[66] the same decision —applying the business judgment rule[67]—that principle would seem to control here. Once the adviser determines that recapture is in the best interests of the fund, any failure to recapture—or any arbitrary time limit upon the future operation of recapture—would appear to conflict with the initial determination. Hence failure to recapture, even though recapture was first undertaken in a settlement situation, would appear to be in derogation of a duty owed to the fund by its management adviser.

The SEC argues also that imposition of the duty to recapture, even where the obligation is initially undertaken voluntarily, is supported by the Commission's ruling in *Provident Management*.[68] There, the SEC had ruled that give-ups and reciprocals actually received in connection with fund portfolio transactions had to be credited "against Fund's contractual obligation to pay its advisory fee."[69] In light of this ruling, the SEC in *Gross* and *Edelman* contends that, notwithstanding the fact that management's decision to enter into recapture was based on a desire to settle the current litigation, once recapture was determined to be in the best interests of the fund, the defendants had a duty to continue the practice.[70]

On the other hand, the defendants in *Gross* and *Edelman* argue that their agreement to enter into the brokerage business is ample consideration for settling the litigation, since a management company is under "no duty—fiduciary or otherwise—to enter the brokerage business or become a member of a stock exchange."[71] Furthermore, the defendants contend that the SEC is unjustified in its assertion that the proposed settlement provides less than the law requires. In support of this position, the defendants argue that "entry into the brokerage business involves a substantial commitment of time and money and the

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65 445 F.2d at 374.

66 Miller & Carlson, Recapture of Brokerage Commissions by Mutual Funds, 46 N.Y.U. L. Rev. 35, 46 (1972).

67 Id.

68 SEC Brief, supra note 60, at 11-12.

69 Id. at 12.

70 Id.

71 Brief for Defendants, Gross v. Moses, supra note 30, at 23.

assumption of serious and substantial risks."[72] Consequently, the defendants believe that their offer is a significant concession which goes beyond the fiduciary obligations established by the First Circuit in *Moses*.

A narrow reading of that decision may afford some support to the defendants' position. The *Moses* court's determination was directed solely to the defendants' duty to recapture give-ups. The decision did not involve reciprocal brokerage. Therefore it may be argued that the adviser's duty to recapture for the fund's benefit extends only to situations where give-ups are concerned. Assuming this to be the case, an offer to enter into the brokerage business and recapture reciprocal commissions for the fund may provide fair and adequate consideration for settlements since such an arrangement would be more than the defendants are required to provide according to law. It should be noted, however, that even though the decision in *Moses* did not directly involve the use of reciprocals, the First Circuit suggested that granting reciprocals in some instances might conflict with the duty to recapture.[73]

In any case, other factors appear to rebut the defendants' argument. The SEC's ruling in *Provident Management* required a fund-affiliate to use for the fund's benefit reciprocal brokerage received from fund portfolio brokerage transactions. Furthermore, reciprocals are similar to give-ups in that they both flow from excess commissions on portfolio transactions and are paid to a broker on order of the adviser. In short, the decision in *Moses* and the ruling in *Provident Management* apparently require the conclusion that, while there is no duty to enter into affiliation to effect recapture, whenever an arrangement has been made—whether in the context of litigation settlement or not—then a duty to recapture for the benefit of the fund and its shareholders is imposed. In addition, it is submitted that the probability of success standard requires a settlement favorable to the shareholders in *Gross* and *Edelman*. When *Kurach* was decided, the law was arguably in favor of the defendants, or at least the plaintiffs' probability of success was virtually nonexistent. However, *Moses* has since shifted that probability decidedly in favor of the shareholders. Thus, absent a determination that the plaintiffs' claims are frivolous, the *Gross* and *Edelman* court should reject the settlement proposal because it constitutes a grossly inadequate reflection of the plaintiffs' favorable probability of success.

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[72] Id. at 24.

[73] The court stated that:

> We see no reason to reject the SEC's conclusion that awarding reciprocals even to brokers who have done nothing to benefit the funds is unobjectionable. . . . *This is not to say that granting reciprocals in some particular instance may not conflict with the duty to recapture.*

445 F.2d at 372 n.5 (emphasis added).

F. *The 1972 SEC Policy Statement: Impact on the Pending Litigation*[74]

To date, *Moses* remains the law with respect to recapture. However, several recent developments have had, and may continue to have, an impact on that decision. The SEC, which earlier argued that a duty to recapture exists in a management/broker-affiliate situation, has now disclosed an intention to limit institutional membership—that is, membership of brokers affiliated with financial institutions[75]—on stock exchanges[76] and thereby inhibit recapture arrangements. In a recent policy statement the SEC stated that it will seek legislation to prohibit the membership on stock exchanges of those firms whose *primary* function is to recapture brokerage commissions.[77] The Commission's basic contention is that to allow institutional membership *merely* for the purpose of effecting recapture is to permit exchange membership to be used for private rather than public purposes.[78] Essentially, the Commission reasoned that as long as the industry is beset with a fixed minimum commissions rate structure, "large investors should not, by virtue of their economic power and size, be entitled to obtain rebates of commissions not available to [small, individual] investors."[79] The Commission considers that such private use of stock exchanges frustrates the public's confidence in the securities market.[80]

The Commission's dramatic shift from its earlier position on recapture raises the question whether the failure to recapture will provide a cause of action for shareholders in future litigation. However, the new policy statement should not limit the impact of *Moses* on the plaintiffs' probability of success in the more than fifty pending recapture suits. The *Moses* court has made it clear that there are legal methods of recapture and circumstances wherein recapture is legally required. Thus, even if the courts should accept the Commission's new position, this shift should have only a prospective influence on the probability of success factor; the pending actions are concerned

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[74] SEC Policy Statement, Future Structure of the Securities Markets (Feb. 1972) [hereinafter cited as SEC Policy Statement].

[75] For a discussion of, and an argument for, institutional membership, see Wetherill & Hender, Institutional Membership and the Experience of the Philadelphia-Baltimore-Washington Stock Exchange, at p. 1021 supra.

[76] SEC Policy Statement, supra note 74, at 53-54.

[77] Id. The SEC has stated that all exchange members should be required to conduct "public" brokerage business and that "any brokerage firm which is not doing a *predominant portion* of its brokerage commission business for non-affiliated persons should not be considered to be conducting a public brokerage business." Id. at 53 (emphasis added). The Commission also indicated that "[p]redominant means . . . significantly more than half." Id. at 54. Recently the SEC stated that "predominant" means "significantly more than two-thirds" and perhaps 90%. The N.Y. Times, Feb. 6, 1972, § 3 (Business and Finance), at 9, col. 2.

[78] SEC Policy Statement, supra note 74, at 47.

[79] Id. at 46-47.

[80] Id. at 47-48.

with a period of time when management defendants could have and should have recaptured brokerage commissions.

Moreover, the SEC's proposed restriction on institutional membership has been attacked by several regional stock exchanges which support such membership, particularly the Philadelphia-Baltimore-Washington Exchange (P-B-W), which has indicated that it will fight the SEC proposal.[81] In addition, members of Congress have criticized the Commission's policy,[82] and Senator Harrison A. Williams, chairman of the Senate Banking Subcommittee, has introduced a bill which would temporarily enjoin implementation of the SEC plan in order to allow Congress to study the situation.[83]

It must be admitted, however, that although the proposed restriction on institutional membership apparently would not impair the plaintiffs' favorable position in the pending litigation, such a restriction could affect the mode of settling those actions. If recapture is to be limited by legislation or by SEC rulings, then an offer to enter into recapture arrangements as a means of settlement might become inadequate and hence unacceptable to the courts. Accordingly, pending offers of settlement would have to take some other form, and settlements already reached would have to be modified insofar as they were based on agreements to recapture.

II. THE MEASURE OF DAMAGES

Although a determination of the plaintiffs' probability of success is essential to the evaluation of the fairness and adequacy of a settlement proposal in recapture litigation, this factor must be considered in conjunction with the damages sustained by the aggrieved shareholders. These damages may be simply defined as the loss of the value of brokerage commissions which could have been recaptured by a fund's adviser. This description, however, fails to suggest the difficulty experienced by most courts in determining such a value,[84] a difficulty attributable to the lack of basic guidelines for the courts to follow in determining where, when and in what amounts commissions could have been recaptured. The sophisticated nature of fund portfolio transactions,[85] coupled with the courts' tendency to defer to the business judgment of fund advisers,[86] has apparently constituted another obstacle to a successful judicial determination of an appropriate measure of damages. For these reasons, prior to *Moses v. Burgin*, courts usually approved any settlement offer whose terms appeared to reflect the probability of success.

[81] See Wall Street Journal, March 2, 1972, at 2, cols. 3-4, and Wetherill & Hender, supra note 75, at 1023.

[82] See Wall Street Journal, Feb. 3, 1972, at 3, col. 2.

[83] S. 3169, 92d Cong., 2d Sess. (1972).

[84] E.g., Kurach v. Weisman, 49 F.R.D. 304, 307 (S.D.N.Y. 1970).

[85] The nature of these transactions is generally discussed in Miller & Carlson, supra note 66, at 42-44.

[86] E.g., Moses v. Burgin, 316 F. Supp. 31, 58 (D. Mass. 1970).

Moses, the first and thus far the only recapture case to reach trial on the merits, is also the only recapture case in which the shareholders' measure of damages was given adequate judicial scrutiny. *Moses* did not establish a definitive standard by which to determine damages in recapture litigation. However, the decision did set forth basic guidelines for computing such damages, guidelines which should provide invaluable assistance to courts evaluating settlement proposals in pending or future recapture disputes.

A. *Exchanges on Which Loss Was Incurred*

In ascertaining the value of brokerage commissions which could have been recaptured for the benefit of the plaintiffs, the *Moses* court found that it was first necessary to determine on which exchanges recapture was allowed.[87] Absent proof as to which exchanges permit recapture, the aggrieved shareholders would be unable to establish where recapture should have been effected. Accordingly, the plaintiffs could not show the extent of loss incurred. The plaintiffs in *Moses* established only that the Philadelphia-Baltimore-Washington Stock Exchange and the Pacific Coast Stock Exchange (PCSE) permitted recapture situations[88]—*i.e.*, allowed membership on the exchange by brokers affiliated with financial institutions. The court acknowledged that other exchanges probably allowed recapture, but ruled that the "initial burden" was on the shareholders to prove that they did so.[89] Since the plaintiffs had not offered the requisite proof at trial before the lower court, the appellate court refused to allow further consideration of the question.[90]

The plaintiffs did introduce evidence indicating that only two of the regional exchanges asked if they would permit recapture responded affirmatively, while none of the national exchanges did so.[91] Those exchanges that refused to allow institutional membership, and thus prohibited recapture, did so on the grounds that tolerating recapture would conflict with their anti-rebate rules. However, it should be noted that, after this inquiry had been made, other regional exchanges relaxed their admissions requirements and began to allow institutional membership.[92] Moreover, as noted earlier, the SEC has recently proposed that all exchanges admit institutional members, provided that those members perform a "predominant portion" of their business for the general public rather than for their affiliate institutions.[93] These developments, increasing the availability of recapture arrangements, should substantially mitigate the shareholders' burden of proof on the

[87] 445 F.2d at 384.

[88] Id.

[89] Id.

[90] The court stated that "[t]his issue seems to us to fall, strictly, under the question of liability, and not under questions of damages. . . ." Id.

[91] See text at note 88, supra.

[92] See note 26, supra.

[93] SEC Policy Statement, supra note 74, at 53-54.

exchanges issue. Indeed, should the SEC's proposal be implemented and all exchanges required to allow recapture, all that need be established is the extent to which recapture could be effected in light of the "predominant portion" rule.

Having established which exchanges allowed recapture, the plaintiffs then had to show that the defendants had been in a position to utilize those exchanges for the fund's portfolio transactions.[94] The plaintiffs in *Moses* were able to establish that their fund's adviser owned an underwriter which could have entered into recapture for the fund on both the P-B-W and PCSE, and that the exchanges would allow the underwriter to receive give-ups which could then be credited against the funds' advisory fee.[95]

B. *Date From Which Defendants Should Have Begun Recapture*

Having ascertained *where* recapture could have been effected, the *Moses* court then ruled that it was necessary for the plaintiffs to establish the date from which the defendants "should have been alerted" to the fact that recapture was possible.[96] This date is an important element in the computation of damages, since it enables the courts to ascertain the specific period of time—beginning with this date and ending when recapture is implemented—within which the transactions giving rise to the shareholders' loss occurred. Inherent in the court's ruling that the defendants were liable from the time they "should have been alerted" to the possibility of recapture is a determination that, notwithstanding any legitimate initial reservations by the fund's advisers as to the advisability of recapture, liability should be imposed for every failure to recapture during this period of uncertainty if it is subsequently determined that recapture would have been advantageous. The court held that the defendants should have banked all give-ups which might have been recaptured during the period of doubt, until such time as they could have made an unequivocal decision on the matter.[97]

The problem, then, is to ascertain what particular event should have sufficiently "alerted" the fund's adviser. The *Moses* court held "as a matter of law, in view of the [SEC's 1966 mutual fund study] that th[e] date could be no later than March 1, 1967,"[98] but did not reveal precisely why this date was chosen as an outside limit. However, it may be surmised that the court selected the date because it represents a period of three months after the publication, in December, 1966, of the SEC report[99] which unequivocally disclosed the possibility and desirability of recapture. The court apparently regarded three months as a

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94 445 F.2d at 374-75.

95 Id. at 382.

96 Id. at 385.

97 Id.

98 Id.

99 Report of the SEC on the Public Policy Implications of Investment Company Growth, H.R. Rep. No. 2337, 89th Cong., 2d Sess. (1966).

reasonable time within which the funds' advisers might begin to effect recapture. With this "outside" date as a guide, the court ruled that determining the actual date on which the defendants "should have been alerted" presented a question of fact to be resolved on remand by the district court "from the present record in the light of this opinion."[100]

Although the district court has not yet decided this issue, the appellate opinion provides grounds for inferring that the lower court could find that the period of liability began before March, 1967. The appellate court suggested that the defendants were doubtless alerted to the possibility of recapture on no less than three occasions. The first occurred at SEC hearings conducted in 1965,[101] when a Commission official suggested to the defendants that recapture might be possible on the Detroit Stock Exchange.[102] The appellate court felt that this "suggestion should clearly have imparted to Management the idea that its benefit [in retaining give-ups] could now conflict with Fund's interest [in recapture]."[103] This suggestion was reintroduced to the defendants during another SEC proceeding in September, 1966.[104] The appellate court remarked that "by this time the conflict was clearly laid out."[105] Finally, the possibility of recapture was placed before the entire mutual fund industry, including the defendants, by the SEC report published in December, 1966.

It is submitted that, of these three occasions, the 1966 SEC proceedings should be found to mark the actual date from which the defendants should have been alerted to the possibility of recapture. It is conceivable that the 1965 proceeding had not adequately apprised the defendants of the feasibility of recapture, even though they were already aware "that the principal beneficiaries of fund-paid portfolio commissions are not the funds, but the advisers and underwriters."[106] The court admitted that "[w]hat was new [in the 1965 proceedings] was the suggestion of *how*, in fact, the interests of Fund could be better served."[107] In any case, by the time of the 1966 proceedings the defendants should have become sensitive to the possibility of using recapture in the interests of the fund. The proceedings themselves could then be found to constitute the occasion on which the adviser must be considered "alerted" to the possibility of recapture, and accordingly under a duty to bank subsequent give-ups pending a final decision on the advisability of recapture.

It is also submitted that the court was correct in determining that

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100 445 F.2d at 385.

101 Id. at 377.

102 The defendants' response to such a suggestion was negative, at best, and they indicated that "the change [to recapture] would irritate dealers who had been receiving give-ups and have a consequent bad effect upon sales." Id.

103 Id.

104 Id. at 378.

105 Id.

106 Id. at 377.

107 Id. (emphasis added).

the defendants should have been definitely aware of the possibility of recapture no later than March 1, 1967. As the court succinctly stated:

> [T]he September, 1966 proceedings were shortly followed by the Commission's own, formal . . . report. Management defendants, whatever their own views on the feasibility of recapture, *were then on full notice* that the possibility of recapture was a substantial issue that directly involved their self-interest. Any contention that the Commission's views were off-hand or so inconsequential that Management defendants were entitled to keep their own counsel . . . is, to put it bluntly, little short of extraordinary.[108]

The *Moses* court seemed to imply that other courts, which must render judgments or approve settlement offers in pending and future recapture litigation, should accept the same "outside" date. The SEC's published report was both available and applicable to all investment advisers and should have put the entire industry on notice. Hence it is submitted that the *Moses* date should generally be adhered to.

C. *The Amount of Loss*

The final question to be decided on remand was the computation of the amount of damages sustained by the plaintiffs after the date on which the adviser should have been "alerted." The appellate court ruled that "the Management defendants are to be held *liable for all transactions, making allowances for best execution, and all resulting give-ups that could have been recaptured* on those [exchanges which allowed recapture]."[109] The central problem in computing damages, then, is the problem of determining whether a certain transaction was made consistent with "best execution."

In essence, best execution requires that investment management seek the best possible price in trading a fund's portfolio securities by purchasing those securities at the lowest possible price and selling them at the highest.[110] However, the average price per share paid on a transaction is not the only criterion for determining whether there has been best execution. Other factors, such as the savings realized by a fund because of recapture, the speed with which a broker can clear an order, or the superior service offered by a particular nonaffiliated broker, are also important.[111] For example, an immediate need to raise cash to make a desirable investment might justify selling a stock at less than its market price even though that price could have been realized at some future date.

The recapture issue introduces still another variable. The district

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108 Id. at 383-84 (emphasis added).

109 Id. at 385 (emphasis added).

110 Glazer, A Study of Mutual Fund Complexes, 119 U. Pa. L. Rev. 205, 242-43 (1970).

111 Id.

court first will have to decide what benefits would have been realized by recapture and then determine whether any of the benefits derivable from best execution would have been diminished, had the adviser actually pursued recapture.[112] Should the court find that recapture would have diminshed other benefits, it must reduce the defendants' liability accordingly. The obvious difficulty is that it will be necessary to examine each fund transaction individually.

It is submitted that the *Moses* court's decision may be interpreted to provide a possible response to this difficulty. It implies that, once the first two elements of the measure of damages—on which exchanges and from what date recapture could have been effected—are established, a presumption may arise, in favor of the plaintiffs, that a transaction which could have resulted in recaptured brokerage would have been consistent with best execution. Should this be an accurate interpretation, the *Moses* decision should have a marked impact on pending and future settlements. For example, management will have to rebut the presumption for each transaction in which it failed to seek recapture and show that the transaction was in fact consistent with best execution. Nor will the adviser be relieved from the burden of the presumption if the transaction was made on an exchange that prohibited recapture. If a trade could be made on either of two exchanges, of which one allowed recapture while the other did not, and the prices involved were identical, then best execution would demand that the trade be performed on the exchange which favored recapture.

Thus, although the *Moses* court did not compute the actual damages sustained by the shareholders, the court's decision did offer the district court a clear and workable method for arriving at an appropriate figure. In so doing, the court has provided a valuable guide to all courts for determining the measure of damages in recapture litigation. More particularly, tribunals which are presently sitting on pending disputes need no longer guess at the adequacy of a settlement offer because of uncertainty as to the measure of damages. These courts can compute this amount by determining three factors: the exchanges on which recapture was allowed and whether the fund had the necessary affiliations to effect recapture; the date from which the fund's adviser should have been alerted to the possibility of recapture; and all of the transactions, making allowances for best execution, that could have been recaptured during that period on those exchanges. The shareholders' loss will be the amount of commissions which could have been recaptured. It is submitted that the expected willingness of the defendants to settle these pending disputes will probably obviate the need for a precise dollars and cents tabulation of damages by the courts, since a settlement hearing does not require so extensive an examination of those facts as does a full trial on the merits.[113] Guided by the

[112] Id. at 243.

[113] See Florida Trailer & Equip. Co. v. Deal, 284 F.2d 567, 571 (5th Cir. 1960).

three-step procedure in *Moses*, the courts should be able to estimate the measure of damages with reasonable accuracy.

CONCLUSION

In recently instituted derivative suits, many mutual fund shareholders have challenged the failure of fund advisers to recapture certain brokerage commissions paid on fund portfolio transactions. Many of these suits are now pending before the courts and will probably be resolved by settlement agreements between the parties to the disputes. The courts will have to approve these settlements and, as guardians of the shareholders' interests, will have to insure that the agreements are fair and adequate when measured by the shareholders' probability of success at trial and an appropriate measure of damages.

It is submitted that gauging the shareholders' probability of success and estimating the measure of damages by the *Moses* guidelines should enable the courts to execute effectively their role as guardians of the shareholders' interests by making realistic determinations of the fairness and adequacy of settlement offers. A reasonable approximation of the measure of damages will apprise the courts of the extent to which the plaintiffs have suffered a loss. The courts will be able to estimate fairly, in terms of the probability of success, what portion of this amount would have been recovered had there been a full trial on the merits. Having estimated the probable recovery at trial, the courts will then be able to approve, as fair and adequate, settlement offers which realistically reflect this recovery, making allowances for such mitigating factors as the time and expense saved by not going to trial, and the speedy receipt of settlement payments as contrasted with delayed recovery while defendants exhaust their procedural remedies.

JAMES J. SHIRLEY