MEMO# 21364

July 16, 2007

Parties Enter into Stipulation of Settlement to Resolve Pending Class Action Case Involving Revenue Sharing Arrangements

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TO: COMPLIANCE MEMBERS No. 35-07
SEC RULES MEMBERS No. 84-07
SMALL FUNDS MEMBERS No. 56-07
BROKER/DEALER ADVISORY COMMITTEE No. 35-07 RE: PARTIES ENTER INTO STIPULATION OF SETTLEMENT TO RESOLVE PENDING CLASS ACTION CASE INVOLVING REVENUE SHARING ARRANGEMENTS

In November 2005, a class action lawsuit was filed against a financial services company, its mutual funds, and its funds' advisers and distributors. Without admitting or denying the suit's allegations, on July 5th, the parties entered into a Stipulation of Settlement [1] to resolve the plaintiffs' claims that the defendants' revenue sharing and directed brokerage arrangements violated the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940. In settling this matter, the defendants have agreed to pay approximately $1,150,000, which represents $1,500 paid to the lead plaintiff and $1,148,500 paid into a settlement account for the benefit of the "Settlement Class Members." In addition, the defendants have agreed to amend the funds' prospectus and SAI disclosure relating to revenue sharing payments. The plaintiffs' allegations and the material terms of the Stipulation are briefly summarized below.

The Plaintiffs' Allegations

The plaintiffs' suit alleged that, from 2000-2005, the defendants violated the federal securities laws through their "undisclosed" directed brokerage, revenue sharing payments (including payments for shelf space), and additional incentives provided to financial consultants who sold the defendants' mutual funds. They also alleged that the funds' prospectus and SAI disclosure relating to these activities was materially false and misleading and that the defendants charged excessive fees that were not reasonably related to the services they provided. The plaintiffs' complaint noted that some of the defendants had been censured and fined by the NASD in connection with their revenue sharing and directed brokerage arrangements. [2]

The plaintiffs alleged that the defendants' conduct violated the antifraud provisions of Section 12(a)(2) of the Securities Act and Section 10(b) of, and Rule 10b-5 under, the Securities Exchange Act. They further alleged that defendants' conduct constituted a breach of fiduciary duty pursuant to Section 36(b) of the Investment Company Act and were subject to the control person liability provisions of Sections 15 and 20 of the Securities Act and Exchange Act, respectively. Their complaint sought compensatory damages for the class, the return of excessive fees pursuant to the Sections 36(b) claim, and costs and expenses, including attorneys' fees.

The Terms of the Stipulation

According to the Stipulation, the Lead Plaintiff and Lead Counsel believed that "success is not assured" on the plaintiffs' Exchange Act and Investment Company Act claims, and that "their best case" would be with respect to revenue sharing payments made by two funds, one in the amount of $1.7 million and the other of approximately $87,500 . [3] The defendant agreed to pay $1,148,500 into a Settlement Account for the benefit of the Settlement Class members. The Settlement Account is to be the sole source of funds from the defendants for payment of any claims to the plaintiffs, including the payment of counsel fees and expenses and administrative expenses. In addition to the monetary settlement, the defendants agreed to amend the disclosure in certain of the funds' prospectuses and SAIs that relates to revenue sharing payments. Exhibits 6 and 7 to the Stipulation consist of the language to be included in the defendants' prospectuses and SAIs, respectively, pursuant to the Stipulation. [4] (For the most part, the SAI disclosure required by Exhibit 7 consists of a list of those NASD member firms that receive payments out of the defendants' revenues for the members' sale and distribution of shares of the funds or for services provided to the funds and their shareholders.) Such revised disclosure is to be added to these documents as they are amended and/or issued "in the normal course of business," and must be included in the documents for at least two years. However,

> [s]hould the [SEC] or any other body with regulatory authority over the mutual fund industry mandate disclosure on any or all of the subjects covered by the Stipulated Disclosures, then, such Regulatory Disclosures shall control over the Stipulated Disclosures, relieving Defendants of their obligations to include such Stipulated Disclosures . . . even if the Regulatory and Stipulated Disclosures are not in conflict. [5]

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Attachment

endnotes

[1] *See Stipulation of Settlement, Siemers v.Wells Fargo & Company, et al.,* No. 05-04518 WHA (N.D. CA 2007) (the "Stipulation"), which is attached.

[2] *See " NASD Charges 15 Firms with Directed Brokerage Violations, Imposes Fines Totaling More than $34 Million,"* (June 8, 2005), which is available at: http://www.nasd.com/PressRoom/NewsReleases/2005NewsReleases/NASDW_014340.

[3] According to the Stipulation, the court had previously determined that,

> . . . to prove the claims under the Exchange Act, Lead Plaintiff will be required to show, among other things, that (1) the defendant fund adviser had a practice of extracting excessive advisory and other fees from the [funds], (2) that these excessive fees were imposed to satisfy ongoing revenue-sharing obligations to selling agents in exchange for promoting [the funds] for the benefit of [the defendant] but not the existing investors, (3) that these arrangements were not adequately disclosed to investors, (4) that the non-disclosure was material, (5) that investors relied thereon (or that their reliance can be presumed), and (6) that the actions caused remediable loss to Lead Plaintiff and members of the certified class. With respect to the first point – the excessiveness of the fees – the Court further held that Lead Plaintiff would be required to show that the fees were excessive as judged under the factors set forth in *Gartenberg v. Merrill Lynch Asset Management,* 694 F.2d 923 (2d Cir. 1982), which requires analysis of (1) the nature and quality of services provided to fund shareholders, (2) the profitability of the fund to the adviser-manager, (3) fall-out benefits to Defendants from their sales of the funds, (4) economies of scale in administering the funds, (5) fee structures of comparable funds, and (6) the independence and conscientiousness of the trustees.

See Stipulation at pp. 3-4.

[4] Copies of Exhibits 6 and 7 are attached.

[5] Stipulation at p. 15.
