

The Honorable \_\_\_\_\_

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UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON AT SEATTLE

ROBERT KENNY,

Plaintiff,

No. 14-1987

v.

**COMPLAINT**

PACIFIC INVESTMENT MANAGEMENT  
COMPANY LLC, a Delaware limited liability  
company; PIMCO INVESTMENTS LLC,

**JURY DEMAND**

Defendants.

COMPLAINT  
(CASE NO. 14-1987)

**KELLER ROHRBACK L.L.P.**

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1 Plaintiff, Robert Kenny, for the use and benefit of the PIMCO Total Return Fund, sues  
2 Defendants Pacific Investment Management Company LLC (“PIMCO”) and PIMCO  
3 Investments LLC, and alleges:

4 1. Plaintiff is a shareholder of the PIMCO Total Return Fund (the “Total Return  
5 Fund” or the “Fund”), the mutual fund that until recently had the largest amount of assets under  
6 management in the world. Plaintiff brings claims against the Fund’s investment advisor  
7 (PIMCO) and subsidiary distributor (PIMCO Investments LLC) under Section 36(b) of the  
8 Investment Company Act of 1940 (“ICA”) (15 U.S.C. § 80a-35(b)), which imposes a fiduciary  
9 duty on the Defendants to ensure that the compensation they receive is not excessive. Here,  
10 Defendants PIMCO and PIMCO Investments LLC have breached that duty by receiving  
11 excessive compensation from the Fund, Plaintiff, and the other Fund shareholders that is so  
12 disproportionately large that it bears no reasonable relationship to the services rendered and  
13 could not have been the product of arm’s-length negotiations.

14 2. With this Complaint, Plaintiff seeks to: 1) rescind the investment advisory  
15 agreements, the supervisory and administration agreements (“administrative” agreements), and  
16 the distribution and servicing agreements the Fund has entered into with Defendants; and  
17 2) recover the amounts charged by Defendants or, alternatively, recover any improper  
18 compensation retained by Defendants in breach of their fiduciary duty under Section 36(b) of the  
19 ICA, as amended. Because the conduct complained of herein is continuing in nature, Plaintiff  
20 seeks recovery for a period commencing at the earliest date in light of any applicable statute of  
21 limitations through the date of final judgment after trial.

1                                   **I.        JURISDICTION AND VENUE**

2            3.        This action is a derivative action brought by Plaintiff on behalf of the PIMCO  
3 Total Return Fund pursuant to § 36(b) of the ICA, as amended and codified at 15 U.S.C. § 80a-  
4 35(b).

5            4.        This Court has subject matter jurisdiction pursuant to 15 U.S.C. § 80a-43, 15  
6 U.S.C. § 80a-35(b)(5), and 28 U.S.C. § 1331.

7            5.        Personal jurisdiction and venue are proper in this judicial district pursuant to 15  
8 U.S.C. § 80a-43 and 28 U.S.C. § 1391(b). Defendants transact business in this District, a  
9 substantial part of the events or omissions that give rise to Plaintiff’s claims occurred in this  
10 District, and/or Defendants may be found in this District.

11           6.        No pre-suit demand on the Board of Trustees that oversees the PIMCO Total  
12 Return Fund is required, as the requirements of Federal Rule 23.1 do not apply to actions brought  
13 under § 36(b) of the ICA. *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 542 (1984).

14           7.        All conditions precedent have been performed or have occurred.

15                                   **II.       PARTIES**

16 **A.       Plaintiff**

17           8.        Plaintiff Robert Kenny is a resident of Clinton, Washington, and is a shareholder  
18 of the PIMCO Total Return Fund. In 2011, Plaintiff contacted PIMCO from his home in Clinton  
19 to begin investing in the Fund. Plaintiff undertook and completed all the transactions necessary  
20 to invest in the Fund through repeated contacts with PIMCO representatives via the telephone,  
21 email, U.S. Mail, and PIMCO’s websites. All of these contacts and transactions occurred in  
22 Clinton, Washington, at Plaintiff’s home. Plaintiff has continued to contact PIMCO  
23 representatives from his home—and Defendants’ representatives have continued to contact

1 Plaintiff at his home—regarding his accounts via telephone, email, U.S. Mail, telefax, and  
2 through PIMCO’s websites.

3 **B. The Fund**

4 9. The PIMCO Total Return Fund is a mutual fund held in the PIMCO Trust, an  
5 open-end management investment company registered under the ICA. The Fund is the largest of  
6 the 90<sup>1</sup> PIMCO mutual funds held in the Trust, for which Defendants provide investment  
7 advisory, administrative, and distribution services. At the close of the fiscal year 2013 (*i.e.*  
8 March 31, 2014), the PIMCO Total Return Fund held over \$230 *billion* in assets under  
9 management. The Fund “seeks maximum total return, consistent with preservation of capital and  
10 prudent investment management,” by “investing under normal circumstances at least 65% of its  
11 total assets in a diversified portfolio of Fixed Income Instruments of varying maturities. . . .”  
12 PIMCO Funds, Prospectus, at 28 (July 31, 2014).

13 10. The Fund was until recently the largest mutual fund in the world.

14 11. Defendant Pacific Investment Management Company LLC is a Delaware limited  
15 liability company headquartered in Newport Beach, California, that actively maintains a  
16 presence in various locations throughout the United States. PIMCO is a registered investment  
17 advisor under the Investment Advisers Act of 1940. PIMCO received compensation from the  
18 Fund and all funds in the Fund Complex for investment advisory and administrative services it  
19 provides to the Fund and the other funds in the Fund Complex.<sup>2</sup> Defendant PIMCO regularly  
20

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21 <sup>1</sup> As of November 7, 2014. *See* PIMCO Funds, Statement of Additional Information, at 1 (July 31, 2014, as  
22 supplemented November 7, 2014) (“2013 SAI”).

23 <sup>2</sup> PIMCO is a majority owned subsidiary of Allianz Asset Management, with minority interests held by certain of its  
24 current and former officers, by Allianz Asset Management of America LLC, and by PIMCO Partners, LLC, a  
California limited liability company. Prior to December 31, 2011, Allianz Asset Management was named Allianz  
Global Investors of America L.P. PIMCO Partners, LLC is owned by certain current and former officers of

1 transacts business in Washington, including, but not exclusively, through the network of broker-  
2 dealers and financial firms with whom it does business.

3 12. Defendant PIMCO Investments LLC is headquartered in New York, New York.  
4 Defendant PIMCO Investments LLC is a registered broker-dealer under the Securities and  
5 Exchange Act of 1934 and a member of FINRA. PIMCO Investments LLC is registered to  
6 operate in Washington State. On information and belief, it also maintains offices in Newport  
7 Beach, California. PIMCO Investments LLC is a wholly-owned subsidiary of PIMCO and an  
8 indirect subsidiary of Allianz SE. Defendant PIMCO Investments LLC received compensation  
9 from the Fund and the other funds in the Fund Complex as the distributor and principal  
10 underwriter of the Fund and the other funds in the Fund Complex. Defendant PIMCO  
11 Investments LLC regularly transacts business in Washington, including, but not exclusively,  
12 through the network of broker-dealers and financial firms with whom it does business.

### 13 III. GENERAL BACKGROUND

#### 14 A. The Investment Company Act of 1940

15 13. Congress recognized as early as 1935 that mutual funds “present[ed] special  
16 features which require[d] attention beyond simply the disclosure philosophy of the Securities Act  
17 of 1933,” *see* H.R. Rep. No. 91-1382, at 2 (1970), because “a typical [mutual] fund is organized  
18 by its investment advisor which provides it with almost all management services and because its  
19 shares are bought by investors who rely on that service, a mutual fund cannot, as a practical  
20 matter sever its relationship with the advisor,” S. Rep. No. 91-184, at 5 (1969). Therefore, “the  
21 forces of arm’s-length bargaining do not work in the mutual fund industry in the same manner as  
22

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23 PIMCO. Through various holding company structures, Allianz Asset Management is majority owned by Allianz SE.

1 they do in other sectors of the American economy.” S. Rep. No. 91-184, at 5 (1969); *see also*  
2 *Jones v. Harris Assocs. L.P.*, 559 U.S. 335, 338 (2010). Rather, “the relationship between  
3 investment advisers and mutual funds is fraught with potential conflicts of interest,” *Burks v.*  
4 *Lasker*, 441 U.S. 471, 481 (1979), and “potentially incestuous,” *Gartenberg v. Merrill Lynch*  
5 *Asset Mgmt., Inc.*, 694 F.2d 923, 929 (2d Cir. 1982).

6 14. Accordingly, in 1940, Congress enacted the Investment Company Act  
7 recognizing that:

8 [T]he national public interest and the interest of investors are adversely  
9 affected...when investment companies are organized, operated [and]  
10 managed...in the interest of...investment advisers...rather than in the interest of  
[shareholders]...or when the investment companies...are not subjected to  
adequate independent scrutiny.

11 ICA § 1(b)(2), 15 U.S.C. § 80a-1(b). The ICA was designed to regulate and curb abuses in the  
12 mutual fund industry and to create standards of care applicable to investment advisers such as  
13 Defendant PIMCO.

14 15. In the 1960s, it became clear to Congress that investment advisers to mutual funds  
15 were gouging the funds with excessive fees. A report produced by the Wharton School that the  
16 SEC commissioned found that investment advisers tended to charge mutual funds “substantially  
17 higher” rates than they charged other clients. *A Study of Mutual Funds Prepared for the*  
18 *Securities and Exchange Commission by the Wharton School of Finance and Commerce*, H.R.  
19 Rep. No. 2274, at 29 (1962). Thereafter, the SEC concluded in a study it conducted that board  
20 and shareholder approval could not protect shareholder interests with respect to advisory  
21 compensation because as a practical matter mutual funds could not terminate their relationships  
22 with their advisers. *Report of the Securities and Exchange Commission on the Public Policy*  
23 *Implications of Investment Company Growth*, H.R. Rep. No. 2337, at 148 (1966).



1 16. As a result, Section 36(b) was added to the ICA in 1970 primarily to afford  
2 oppressed fund shareholders with a remedy to recover the excessive fees charged by mutual  
3 funds such as that owned by Plaintiff, creating a federal cause of action for breach of fiduciary  
4 duty by investment advisers. The statute provides for quasi-derivative claims (with no demand  
5 requirement).

6 17. Section 36(b) provides in pertinent part:

7 [T]he investment adviser of a registered investment company shall be deemed to  
8 have a fiduciary duty with respect to the receipt of compensation for services, or  
9 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.

10 ICA § 36(b), 15 U.S.C. § 80a-35(b).

11 18. Further, in enacting Section 36(b), “Congress decided not to rely solely on the  
12 fund’s directors to assure reasonable adviser fees,” *Daily Income Fund*, 464 U.S. at 540, and also  
13 added a provision to Section 36(b) that provides:

14 In any such action approval by the board of directors of such investment company  
15 of such compensation or payments, or of contracts or other arrangements  
16 providing for such compensation or payments, and ratification or approval of such  
17 compensation or payments, or of contracts or other arrangements providing for  
such compensation or payments, by the shareholders of such investment  
company, shall be given such consideration by the court as is deemed appropriate  
*under all the circumstances.*

18 15 U.S.C. § 80a-35(b)(2) (emphasis added). Through Section 36(b), Congress gave shareholders  
19 a “unique right,” *Daily Income Fund*, 464 U.S. at 536, empowering them with the ability to be an  
20 independent check on unfair fees.

21 **B. Inherent Conflict in the Structure of Mutual Funds**

22 19. Mutual funds themselves are basically corporate shells that have few or no  
23 employees. Instead, the mutual fund contracts for all of the services it needs, including

1 distribution of its securities, custodianship of its assets, auditing, servicing shareholder accounts,  
2 portfolio management, and day-to-day operation, all of which are provided by or arranged for by  
3 the investment advisor and their affiliates.

4 20. When a new mutual fund is started, the fund's advisor contracts to provide all the  
5 services the fund needs and also nominates and elects the fund's board of directors or board of  
6 trustees.

7 21. While mutual fund boards are supposed to be the "watchdogs" for the  
8 shareholders of the funds, two noteworthy industry insiders have commented on the general  
9 failure of mutual fund boards to fulfill their responsibilities under the ICA. Jack Bogle, founder  
10 of The Vanguard Group, Inc. ("Vanguard") made the following comment:

11 Well, fund directors are, or at least to a very major extent, sort of a bad joke.  
12 They've watched industry fees go up year after year, they've added 12b-1 fees. I  
13 think they've forgotten, maybe they've never been told, that the law, the  
14 Investment Company Act, says they're required to put the interest of the fund  
shareholders ahead of the interest of the fund adviser. It's simply impossible for  
me to see how they could have ever measured up to that mandate, or are  
measuring up to it.

15 22. Warren Buffet, famous investor and chairman of Berkshire Hathaway, observed  
16 in his letter to shareholders in the 2002 Berkshire Hathaway, Inc. annual report:

17 [A] monkey will type out a Shakespeare play before an "independent" mutual-  
18 fund director will suggest that his fund look at other managers, even if the  
incumbent manager has persistently delivered substandard performance. . . .  
19 Investment company directors have failed as well in negotiating management  
fees. . . . If you or I were empowered, I can assure you that we could easily  
20 negotiate materially lower management fees with the incumbent managers of  
most mutual funds. And, believe me, if directors were promised a portion of any  
21 fee savings they realized, the skies would be filled with falling fees. Under the  
current system, though, reductions mean nothing to "independent" directors while  
22 meaning everything to managers.

23 Berkshire Hathaway, Inc., 2002 Annual Report to Shareholders 17-18 (2013), available at  
<http://www.berkshirehathaway.com/2002ar/2002ar.pdf>.

1           23.     The watchfulness and effectiveness of boards of trustees continues to be an issue  
2 today. Indeed, as Judge Posner observed in his dissent from the denial of a petition for rehearing  
3 en banc in *Jones v. Harris* there are “growing indications that executive compensation in large  
4 publicly traded firms often is excessive because of the feeble incentives of boards of directors to  
5 police compensation.” *Jones v. Harris Assocs. L.P.*, 537 F.3d 728, 730 (7th Cir. 2008), *vacated*  
6 *and remanded*, 559 U.S. 335 (2010). Indeed, “broad cross-sectional analysis reveals little  
7 consistent evidence that board composition is related to lower fees and higher returns for fund  
8 shareholders.” *Id.* at 731 (quoting “OEA Memorandum: Literature Review on Independent  
9 Mutual Fund Chairs and Directors,” Dec. 29, 2006).

10           24.     And, as the Supreme Court held in *Jones*, “where the board’s process was  
11 deficient or the adviser withheld important information, the court must take a more rigorous look  
12 at the outcome” in judging whether a fee received by an investment advisor is excessive. *Jones*,  
13 559 U.S. at 351.

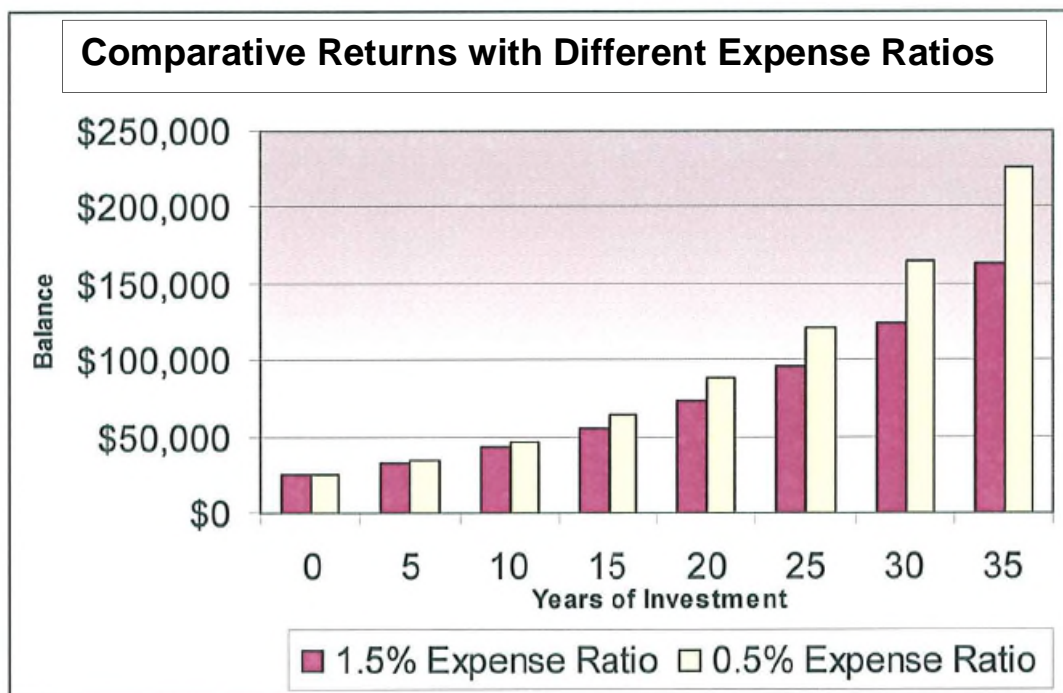
14     **C.     Mutual Fund Fees**

15           25.     While mutual fund fees may appear to be very small on a shareholder-by-  
16 shareholder basis, they may cause a dramatic decrease in a shareholder’s investment returns over  
17 time. Arthur Levitt, past Chairman of the United States Securities and Exchange Commission  
18 (“SEC”), criticized this “tyranny of compounding high costs”:

19           Instinct tells me that many investors would be shocked to know how seemingly  
20 small fees can over time, create such drastic erosion in returns. . . . In the years  
21 ahead, what will mutual fund investors say if they realize too late their returns  
22 have fallen hard under the weight of compounding fees?

23     Arthur Levitt, Jr., *Inaugural Address: Costs Paid with Other People’s Money*, 6 Fordham J.  
24     Corp. & Fin. L. 259, 261, 267 (2001).

26. For example, assume that an employee with 35 years until retirement has a current 401(k) account balance of \$25,000. If returns on investments in their account over the next 35 years average 7 percent, and fees and expenses reduce their average returns by 0.5 percent, their account balance would grow to \$227,000 at retirement, even if there were no further contributions to their account. However, if fees and expenses being withheld are 1.5 percent, their account balance would grow to only \$163,000 at retirement. The 1 percent difference in fees and expenses reduces their account balance at retirement by a shocking **28 percent**.



See *A Look at 401(k) Plan Fees*, U.S. Dep't of Labor,

[http://www.dol.gov/ebsa/publications/401k\\_employee.html](http://www.dol.gov/ebsa/publications/401k_employee.html) (last visited Dec. 28, 2014).

#### **D. Rule 12b-1 Distribution Plans**

27. Prior to 1980, the use of fund assets (which are owned by the shareholders) to sell new fund shares was prohibited. The SEC has historically been reluctant to allow fund advisors to charge their shareholders for selling shares to others:

1 [T]he cost of selling and purchasing mutual fund shares should be borne by the  
2 investors who purchase them and thus presumably receive the benefits of the  
3 investment, and not, even in part, by the existing shareholders of the fund who  
4 often derive little or no benefit from the sale of new shares.

5 “Statement on the Future Structure of the Securities Markets,” Sec. Reg. & L. Rep. (BNA) No.  
6 137 pt. II, at 7 (Feb. 2, 1972).

7 28. After intense lobbying by the mutual fund industry, the SEC agreed to consider  
8 modifying its objections to allow current fund shareholders to pay distribution expenses. In early  
9 comment letters and in proxy statements proposing adoption of plans of distribution, the mutual  
10 fund industry argued that adding assets to an existing mutual fund would generate economies of  
11 scale that would allow the advisors to provide the same quality and nature of services to mutual  
12 fund shareholders at dramatically lower costs.

13 29. Accepting the mutual fund industry’s argument that a growth in assets would lead  
14 to a *quid pro quo* reduction in advisory fees and other expenses, the SEC tentatively approved  
15 Rule 12b-1, 17 C.F.R. § 270.12b-1. However, numerous conditions were attached to the use of  
16 fund assets to pay distribution expenses because the SEC wanted to be certain that investment  
17 advisors would not “extract additional compensation for advisory services by excessive  
18 distributions under a 12b-1 plan.” *Meyer v. Oppenheimer Mgmt. Corp.*, 895 F.2d 861, 866 (2d  
19 Cir. 1990).

20 30. As a result, distribution plans must be reviewed annually by a fund’s trustees. In  
21 particular, the trustees must “request and evaluate . . . such information as may reasonably be  
22 necessary to an informed determination of whether such plan should be implemented or  
23 continued.” 17 C.F.R. § 270.12b-1(d). In addition, minutes must be maintained to record all  
24 aspects of the trustees’ deliberations, and the trustees must conclude “in light of their fiduciary  
duties under state law and under sections 36(a) and (b) (15 U.S.C. § 80a-35(a) and (b)) of the

1 [ICA], that there is a reasonable likelihood that the plan will benefit the company and its  
2 shareholders.” 17 C.F.R. § 270.12b-1(e).

3 31. Unfortunately, notwithstanding the mutual fund industry’s assurances concerning  
4 the *quid pro quo* that shareholders would realize from their payment of distribution fees, the  
5 SEC’s historical concerns have been borne out. A report written by Dr. Lori Walsh, financial  
6 economist at the SEC, studied “whether shareholders do, in fact, reap the benefits of 12b-1  
7 plans.” Her report states:

8 Prior studies have provided evidence that shareholders are not receiving sufficient  
9 benefits from expense scale economies to offset the 12b-1 fee. In fact most of the  
10 studies show that expense ratios are higher for funds with 12b-1 fees by almost  
the entire amount of the fee. This study confirms these results using a more recent  
dataset. . .

11 In all, the evidence demonstrates that 12b-1 plans are successful at attaining faster  
12 asset growth; however, shareholders do not obtain any of the benefits from the  
asset growth. This result validates the concerns raised by opponents of 12b-1  
13 plans about the conflicts of interest created by these plans. . .

14 Lori Walsh, *The Costs and Benefits to Fund Shareholders of 12b-1 Plans: An Examination of  
Fund Flows, Expenses and Returns*, SEC, 4, 18 (2004),

15 <http://www.sec.gov/rules/proposed/s70904/lwalsh042604.pdf>.

16 32. Other academic studies of funds sold through brokers versus direct-sold funds  
17 have confirmed that not only do shareholders not obtain the benefits of asset growth from the  
18 12b-1 plans, but the broker-sold funds actually deliver *lower* risk-adjusted returns, even before  
19 subtracting for distribution costs. Daniel Bergstresser, et al., *Assessing the Costs and Benefits of  
20 Brokers in the Mutual Fund Industry*, 22 Rev. Fin. Stud. 4129 (2009).

#### IV. PIMCO BACKGROUND

##### A. PIMCO Fund Complex

33. As set forth above, the Total Return Fund is held in the PIMCO Trust. A unitary Board of Trustees (the “Board”) oversees the PIMCO Trust and all the funds within it. The Board also oversees four other PIMCO trusts (the PIMCO Variable Insurance Trust, the PIMCO ETF Trust, the PIMCO Equity Series, and the PIMCO Equity Series VIT) that are considered part of a family of PIMCO funds referred to as the “Fund Complex.”<sup>3</sup> As of November 7, 2014, there are 175 PIMCO funds within the Fund Complex. *See* PIMCO Funds, Statement of Additional Information, at 1, 64-65 (July 31, 2014, as supplemented Nov. 7, 2014) (“2013 SAI”). At the close of the fiscal year 2013 (March 31, 2014), the PIMCO Total Return Fund held over \$230 *billion* in assets under management, while the PIMCO Trust held nearly \$2 *trillion* in assets under management.

##### B. Turmoil at PIMCO and the Fund

34. PIMCO’s Total Return Fund is “the most ubiquitous fund in the 401(k) marketplace,” according to Mike Alfred, chief executive at BrightScope, which tracks retirement funds. Kathleen Pender, *Without Gross, is Pimco Total Return Worth Owning?*, SF Gate, Oct. 2, 2014, <http://www.sfgate.com/business/networth/article/Without-Gross-is-Pimco-Total-Return-worth-owning-5795053.php>.

35. William H. (“Bill”) Gross, PIMCO’s founder and former chief investment officer, started the Fund in May 1987. The Fund has enjoyed a massive influx in new investors over the years. At the end of fiscal year 2003, the Fund had \$76 billion in assets under management,

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<sup>3</sup> All of the trustees oversee the PIMCO Trust, the PIMCO Variable Insurance Trust, and the PIMCO ETF Trust, but only two of the trustees (one disinterested and one interested trustee) serve on the Board that oversees the PIMCO Equity Series and PIMCO Equity Series VIT. 2013 SAI at 64-65.

1 which mushroomed to \$230 billion in assets under management by the end of fiscal year 2013.  
2 At its peak, the Fund had over \$292 billion in assets under management in April 2013.

3 36. But as the increase in assets in the Fund led to larger and larger amounts of  
4 compensation being paid to the Defendants, the Fund's performance suffered. In 2012, the Fund  
5 failed to outperform its benchmark, and 60% of the Fund's peers outperformed the Fund. In  
6 2013, the Fund lost 1.92% and trailed 70% of its peers in its worst performance since 1994. E.  
7 Scott Reckard, *Pimco Trustee Assails Exec's Salary*, L.A. Times, Mar. 11, 2014  
8 <http://www.latimes.com/business/la-fi-pimco-gross-pay-20140311-story.html>. In Calendar Year  
9 2013, the Fund performed terribly. For example, shareholders in Class A of the Fund saw returns  
10 of -5.97% before taxes, while shareholders of Class B shares saw returns of -6.36% before taxes.  
11 See PIMCO Funds, Prospectus, at 30 (July 31, 2014, as supplemented Oct. 21, 2014).

12 37. The Fund's poor performance has shaken up management at PIMCO. In early  
13 2014, co-Chief Investment Officer and co-Chief Executive Officer Mohamed El-Erian  
14 announced his departure after purportedly butting heads with Bill Gross over management of the  
15 Fund. Bill Gross reportedly began to lose control of the firm he created and became increasingly  
16 erratic in his management of the Fund. Indeed, before resigning, El-Erian reportedly said to  
17 Gross, in front of more than a dozen colleagues: "I am tired of cleaning up your shit." Gregory  
18 Zuckerman and Kirsten Grind, *Inside the Showdown Atop Pimco, the World's Biggest Bond*  
19 *Firm*, The Wall St. J., Feb. 24, 2014. And in a shocking development, Gross himself quit on  
20 September 26, 2014, leaving to join competitor Janus Capital Group. News of both El-Erian's  
21 and Gross's departures compounded the poor results of the Fund and led to billions of dollars in  
22 redemptions from the Fund. As of September 2014, the Fund had seen outflows of investors for  
23 16 months, totaling over \$60 billion in redemptions. Kristen Grind, *Pimco Seeks Replacements*



1 *for Two Total Return Trustees*, Wall St. J., Sept. 15, 2014, [http://www.wsj.com/articles/pimco-](http://www.wsj.com/articles/pimco-seeks-replacements-for-two-total-return-fund-trustees-1410810393)  
2 [seeks-replacements-for-two-total-return-fund-trustees-1410810393](http://www.wsj.com/articles/pimco-seeks-replacements-for-two-total-return-fund-trustees-1410810393).

3 38. Notwithstanding this poor performance, the compensation PIMCO has received  
4 for its work for the Fund and Fund Complex has remained extraordinary and has led to shocking  
5 payments to its executives. Last year alone, PIMCO paid over **\$1.5 billion** in bonus  
6 compensation to its top executives. Bill Gross and Mohamed El-Erian, PIMCO's now-ex co-  
7 CIOs and co-CEOs, reportedly each received **over half a billion dollars** in bonus compensation  
8 (\$290 million to Gross and \$230 million to El-Erian). PIMCO claims that the compensation it  
9 pays "is designed to pay competitive compensation and reward performance, integrity and  
10 teamwork consistent with the firm's mission statement." 2013 SAI at 95. But no other executive  
11 officer of a peer publicly-traded financial company came close to either of these bonuses on an  
12 individual level. In fact, one must aggregate the compensation of the CEOs of 20 publicly-held  
13 peer finance companies to come close to the amount of money Gross *alone* took home last year.  
14 See Barry Ritholtz, *Guess How Much Money Bill Gross Made Last Year*, BloombergView, Nov.  
15 14, 2014, [http://www.bloombergview.com/articles/2014-11-14/guess-how-much-money-bill-](http://www.bloombergview.com/articles/2014-11-14/guess-how-much-money-bill-gross-made-last-year)  
16 [gross-made-last-year](http://www.bloombergview.com/articles/2014-11-14/guess-how-much-money-bill-gross-made-last-year). And on a per-employee basis, PIMCO generates four times as much  
17 revenue as Goldman Sachs. *Id.*

18 39. Controversy surrounding the amount of compensation paid to Gross led to the  
19 departure of a 23-year Board veteran, William Popejoy, who was forced to resign after butting  
20 heads with Bill Gross. E. Scott Reckard, *Morningstar Cuts PIMCO Fund Rating From Gold to*  
21 *Bronze After Gross Exit*, L.A. Times, Sept. 30, 2014, [http://www.latimes.com/business/la-fi-](http://www.latimes.com/business/la-fi-morningstar-downgrades-pimco-20140930-story.html)  
22 [morningstar-downgrades-pimco-20140930-story.html](http://www.latimes.com/business/la-fi-morningstar-downgrades-pimco-20140930-story.html). Before being removed from the Fund's  
23 Board, Popejoy publicly criticized Gross's compensation, stating "I don't know what Bill

1 [Gross] should be paid, but \$200 million is not appropriate.” *Id.* He elaborated: “[y]ou could hire  
2 2,000 schoolteachers for that money.” *Id.*

### 3 V. SUBSTANTIVE ALLEGATIONS

4 40. Defendants have breached their fiduciary duty pursuant to Section 36(b) of the  
5 ICA with respect to their receipt of investment advisory fees, supervisory and administrative  
6 fees, and distribution and servicing fees from the Total Return Fund because under “all the  
7 circumstances,” the fees they received were unfair to the beneficiaries, i.e., the shareholders of  
8 the Fund, such as Plaintiff Kenny.

9 41. An investment advisor’s fiduciary duty requires both full disclosure and  
10 substantive fairness. *See Jones*, 559 U.S. at 336 (a court’s evaluation of whether an adviser has  
11 breached its fiduciary duty “must take into account both procedure and substance”). Indeed, an  
12 advisor “may not overreach in the amount of his fee even though the other party to the  
13 transaction, in full possession of all the facts, does not believe the fee is excessive.” December  
14 17, 1969 Letter from the Investment Company Institute included with Mutual Funds  
15 Amendments (Part I): Hearings Before the Subcomm. on Commerce and Finance of the H.  
16 Comm. on Interstate and Foreign Commerce, 91st Cong., at 441 (1969) (“1969 Hearings”). *See*  
17 *also* S. Rep. 91-184, at 15-16 (“the ultimate test, *even if the compensation or payments are*  
18 *approved by the directors and stockholders, . . . will be whether the investment adviser has*  
19 *fulfilled his fiduciary duty to the mutual fund shareholders in determining the fee*”) (emphasis  
20 added).

21 42. The essence of a claim for unfair fees is “whether or not under all the  
22 circumstances the transaction carries the earmarks of an arm’s length bargain.” *Jones*, 559 U.S.  
23 at 347 (quoting *Pepper v. Litton*, 308 U.S. 295, 306-307 (1939)). A breach of fiduciary duty

1 occurs “when a fiduciary permits an unreasonable or excessive fee to be levied on the fund,”  
2 1969 Hearings at 189, or “when compensation to the adviser for his services is excessive, in view  
3 of the services rendered—where the fund pays what is an unfair fee under the circumstances.” *Id.*  
4 at 190.

5 43. In the case of fees that involve a conflict of interest, such as here, this standard  
6 requires both fair dealing and a fair price. “An adviser’s compliance or noncompliance with its  
7 disclosure obligations is a factor that must be considered in calibrating the degree of deference  
8 that is due a board’s decision to approve the adviser’s fees.” *Jones*, 559 U.S. at 351. Thus, under  
9 general fiduciary law, a fee that is not the result of a fair process must be given greater scrutiny.

10 44. In *Pepper v. Litton*, 308 U.S. 295 (1939), former SEC Chairman Justice Douglas  
11 further explained the fiduciary duty standard, as he opined that:

12 [fiduciaries’] dealings with the corporation are subjected to rigorous scrutiny and  
13 where any of their contracts or engagements with the corporation is challenged  
14 the burden is on the [fiduciary] not only to prove the good faith of the transaction  
15 but also to show its inherent fairness from the viewpoint of the corporation and  
16 those interested therein. *The essence of the test is whether or not under all the*  
17 *circumstances the transaction carries the earmarks of an arm's length bargain.* If  
18 it does not, equity will set it aside . . . He who is in such a fiduciary position  
19 cannot serve himself first and his cestuis second . . . He cannot use his power for  
his personal advantage and to the detriment of the stockholders and creditors no  
matter how absolute in terms that power may be and no matter how meticulous he  
is to satisfy technical requirements. For that power is at all times subject to the  
equitable limitation that it may not be exercised for the aggrandizement,  
preference, or advantage of the fiduciary to the exclusion or detriment of the  
cestuis. Where there is a violation of those principles, equity will undo the wrong  
or intervene to prevent its consummation.

20 *Pepper*, 308 U.S. at 306-311 (emphasis added). In *Jones*, the United States Supreme Court held  
21 the formulation of the concept of fiduciary duty stated in *Pepper* “expresses the meaning of the  
22 phrase ‘fiduciary duty’ in § 36(b) . . . .” 559 U.S. at 347. Thus, by adopting *Pepper*, the Supreme  
23

1 Court adopted a fiduciary duty standard for Section 36(b) that requires both good faith in the  
2 negotiation process *and* a fair outcome.

3 45. Factors which may be relevant to determining whether Defendants have breached  
4 their fiduciary duty pursuant to Section 36(b) include, but are not limited to: (1) size of the fees;  
5 (2) the extent to which benefits derived from the economies of scale realized as the fund grows  
6 have inured to the benefit of fund shareholders; (3) the nature and quality of the services  
7 rendered; (4) comparative fee structures; (5) the profitability of the funds to the advisor/manager;  
8 (6) fallout benefits (i.e. all benefits directly or indirectly received by persons affiliated with an  
9 investment company and their affiliated persons by virtue of their relationship with an  
10 investment company); and (7) the care and conscientiousness of the directors. A review of these  
11 factors, referred to herein as the “*Gartenberg* factors,” and the facts in this case, demonstrates  
12 that the fees charged by Defendants to the Fund violate Section 36(b).

13 **A. Size of Fees Paid by the Fund to PIMCO**

14 46. Defendants provide the Fund with four purportedly different services for which  
15 they receive compensation from four distinct fees. Within the Total Return Fund, there are eight  
16 classes of shares which roughly fall into two classes: institutional<sup>4</sup> and retail<sup>5</sup> shares. The  
17 institutional shares are “offered primarily for direct investment by investors such as specified  
18 benefit plans, endowments, foundations, corporations and high net worth individuals that can  
19 meet the minimum investment amount.” 2013 SAI at 101. The minimum investment for  
20 institutional shareholders (including the Institutional, Administrative and P Classes) is \$1 million  
21

22 \_\_\_\_\_  
23 <sup>4</sup> This includes both Institutional, Administrative, and P classes of shares.

24 <sup>5</sup> This includes Class A, B, C, D, and R share classes.

1 per account. *Id.* at 121. Minimum investment levels are lower for the retail share classes. With  
 2 certain small exceptions, all shareholders pay the four fees, but the rates vary from class to class.

3 47. The compensation PIMCO receives is calculated based on fee rates (or basis  
 4 points) assessed on the average daily net assets attributable to each class of shares. The following  
 5 chart summarizes the current fee rates charged by share class:

Class	Collected by PIMCO		Collected by PIMCO Investments LLC		Total Fees
	Investment Advisor Fee	Supervisory and Administrative Fee	Distribution Fee	Servicing Fee	
<b>Administrative</b>	0.25%	0.21%	0.25%	--	0.71%
<b>Institutional</b>	0.25%	0.21%	--	--	0.46%
<b>A</b>	0.25%	0.35%	--	0.25%	0.85%
<b>B</b>	0.25%	0.35%	0.75%	0.25%	1.60%
<b>C</b>	0.25%	0.35%	0.75%	0.25%	1.60%
<b>D</b>	0.25%	0.25%	0.25%	--	0.75%
<b>P</b>	0.25%	0.31%	--	--	0.56%
<b>R</b>	0.25%	0.35%	0.25%	0.25%	1.10%

19 48. Instead of being charged a distribution fee, Class A shareholders are charged an  
 20 upfront sales charge or “load fee” as follows:

Sales Range (USD)		Fee %
Under \$100,000		3.75%
\$100,000 but under \$250,000		3.25%
\$250,000 but under \$500,000		2.25%
\$500,000 but under \$1 million		1.75%
>\$1 million		0.00%

49. Defendants' fee rates have changed little since at least 2003. In 2004, the Board approved raising the Distribution fee rate for Class C shares to 0.75% from 0.65% and it also approved forcing the Class B shareholders to pay a Distribution fee rate of 0.75% where no such fee was previously imposed. In 2006, the Supervisory and Administrative Fees doubled for Class D shares from 0.25% to 0.50%. In 2008, the Supervisory and Administrative Fee was raised from 0.18% to 0.21% for the Administrative and Institutional shares. Also in 2008, the Supervisory and Administrative Fee was raised from 0.18% to 0.31% for the Class P shares. In 2010, the Supervisory and Administrative fee rate was reduced from 0.50% to 0.25% for Class D shares. And effective May 2011, the Supervisory and Administrative Fee rate was reduced from 0.40% to 0.35% for Class A, B, C, and R shares.

#### 1. Investment Advisory, Supervisory and Administrative Fees

50. The first fee Defendant PIMCO charges is an investment advisory fee. Pursuant to an "Investment Advisory Contract," Defendant PIMCO charges each fund an advisory fee. Defendant PIMCO claims that the advisory fee reimburses it for making investment decisions, placing orders for the purchase and sale of the Trust's investments, and furnishing the Board with periodic reports on the investment performance of the Fund.

1           51.     The second fee Defendant PIMCO charges is a supervisory and administrative  
 2 fee. Pursuant to the “Supervision and Administration Agreement,” Defendant PIMCO is the  
 3 “Administrator of the Funds” for which it charges a supervisory and administrative fee.  
 4 Defendant PIMCO claims that the supervisory and administrative fee reimburses it for a variety  
 5 costs, including communicating with shareholders, regulatory compliance, and general  
 6 “supervision of the operations of the Funds, including coordination of the services performed by  
 7 the Funds’ transfer agent, custodian, legal counsel, independent registered public accounting  
 8 firm, and others.” 2013 SAI at 81.

9           52.     For the fiscal year 2013, Defendant PIMCO received the following compensation  
 10 from the Fund and its shareholders for these fees:

Received by PIMCO		
Investment Advisor	Supervisory and Administrative	Total Received
\$641,047,097	\$608,321,040	<b>\$1,249,368,137</b>

11  
 12  
 13  
 14  
 15           53.     By at least May 2011, analysts were criticizing the size of PIMCO’s fees for the  
 16 Fund:

17           **If you hold Pimco Total Return, sell it. If you don’t, but you want to own a**  
 18 **solid bond fund, look for something else...** Total Return charges too much in  
 19 light of its size. In particular, the annual expense ratio of 0.75% for Pimco Total  
 20 Return D (PTTDX), the share class that’s available without a load through many  
 discount brokers, imposes a large hurdle for Gross and his team to overcome. The  
 fee is way too high.

21 Steven Goldberg, *Should You Dump Pimco Total Return?* Kiplinger (May 24, 2011), available at  
 22 [http://www.kiplinger.com/article/investing/T041-C007-S001-should-you-dump-pimco-total-](http://www.kiplinger.com/article/investing/T041-C007-S001-should-you-dump-pimco-total-return.html)  
 23 [return.html](http://www.kiplinger.com/article/investing/T041-C007-S001-should-you-dump-pimco-total-return.html) (emphasis in original).

1           54.     In June 2011, the critiques continued: “Pimco’s expense ratios for Total Return  
2 are no better than average, which seems ridiculous for a fund so large, and its prospects are  
3 worse.” Chuck Jaffe, *You don’t need Pimco’s Bill Gross or his bond fund*, Marketwatch (June  
4 17, 2011), [http://www.marketwatch.com/story/you-dont-need-pimcos-bill-gross-or-his-bond-](http://www.marketwatch.com/story/you-dont-need-pimcos-bill-gross-or-his-bond-fund-2011-06-17)  
5 [fund-2011-06-17](http://www.marketwatch.com/story/you-dont-need-pimcos-bill-gross-or-his-bond-fund-2011-06-17).

6           55.     Morningstar, the respected provider of independent investment research, has  
7 repeatedly raised concerns regarding the Fund’s fees, noting in a November 15, 2011 Analyst  
8 Report that: “[t]he fund’s annual expense bite, at 0.46%, certainly looks reasonable at first blush  
9 . . . But we’re talking about the largest mutual fund in the world here . . . PIMCO’s decision to  
10 actually raise the fund’s price from 43 basis points a couple of years ago looked downright  
11 greedy.” Morningstar, PTTRX: Analyst Report, *It’s not quite time to start worrying about this*  
12 *Fund*, Nov. 15, 2011. Morningstar repeated this exact same criticism in its June 28, 2012 and  
13 September 10, 2012 Analyst Report on the Fund. *See* Morningstar, PTTRX: Analyst Report,  
14 *Counting on discretion being the better part of valor*, June 28, 2012; Morningstar, PTTRX:  
15 Analyst Report, *A difficult pace to keep*, Sept. 10, 2012.

16           56.     In September of 2014, Morningstar criticized the Board’s approval of the fees  
17 PIMCO charges for its investment advisory and related services to the Fund:

18           Another elusive issue that falls under the board’s domain is the way in which  
19 PIMCO accounts for and reports the expenses of its funds. In essence, the firm  
20 breaks down the bulk of its funds’ costs into the two large line items of  
21 “investment advisory fees” and “supervisory and administrative fees.” What’s  
22 especially noteworthy about that construct is the parity between those two line  
23 items. The firm’s flagship Total Return fund places the issue into sharp focus.

24           For the fiscal year ended March 2014, Total Return’s advisory fees totaled more  
than \$641 million, while its supervisory and administrative fees clocked in at  
\$608 million. *The proximity of those numbers is perplexing simply because the*  
*first number should represent what shareholders are paying for the expert, value-*  
*added services of an active money manager, while the second should account for*



1 *the relatively commodified costs that are otherwise associated with operating a*  
 2 *fund and servicing shareholder accounts.*

3 Even if one were to argue that some providers of “supervisory and administrative”  
 4 services warrant more compensation than others, it doesn’t make sense that the  
 5 true cost of servicing one of the best-run mutual funds in the history of the  
 6 business is anywhere remotely close to the fair value of its investment advisory  
 7 services. Ultimately, though, it’s a matter of transparency and allowing  
 8 shareholders to understand whether the board is doing enough to make sure that  
 9 investors aren’t overpaying for commodified services, and while the annual report  
 10 does describe what kinds of expenses are included in the “supervisory and  
 11 administrative fees” line item, it does not break down those costs, as other  
 12 competitors do.

13 Morningstar, Stewardship Grade for Fund Firms PIMCO: *The year 2014 is proving to be among*  
 14 *PIMCO’s most eventful 6-7* (Sept. 29, 2014) (“Morningstar Stewardship Report”) (emphasis  
 15 added).

## 16 **2. Distribution Fee and Servicing Fee (12b-1 Fees)**

17 57. The third and fourth fees Defendant PIMCO Investments LLC charges are a  
 18 distribution fee and a servicing fee related to three Rule 12b-1 plans adopted for the Fund.  
 19 Pursuant to a “Distribution and Servicing Plan,” Defendant PIMCO Investments LLC serves as  
 20 the “Distributor” to the Fund. In this role, it serves as the principal underwriter in the continuous  
 21 public offering of each class of the Fund’s shares. The distribution and servicing fees are alleged  
 22 to cover the cost of acquiring new customers to the Fund and for maintaining new shareholder  
 23 accounts. 2013 SAI at 102.

24 58. The Distributor charges fees pursuant to three different 12b-1 plans that vary by  
 share class within the Fund. First, for shareholders of Class A, B<sup>6</sup>, C, and R shares, the  
 Distributor charges a distribution fee and/or a distinct servicing fee pursuant to a “Distribution

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<sup>6</sup> Class B shares are no longer offered for sale to new investors or existing investors except through reinvested  
 dividends and exchanges. 2013 SAI at 102.

1 and Servicing Plan” that is referred to as the “Retail Plan.” Second, for shareholders of  
 2 Administrative classes, the Distributor charges a combined distribution and servicing fee  
 3 pursuant “Distribution and Servicing Plan” that is referred to as the “Administrative Class Plan.”  
 4 Third, for shareholders of Class D shares, the Distributor charges a combined distribution and  
 5 servicing fee pursuant “Distribution and Servicing Plan” that is referred to as the “Class D Plan.”

6 59. And for fiscal year 2013, Defendant PIMCO Investments LLC received the  
 7 following compensation from the Fund and its shareholders:

<b>Received by PIMCO Investments LLC</b>	
<b>Class</b>	<b>Distribution and Servicing</b>
A	\$59,484,781
B	\$2,076,223
C	\$102,949,249
D	\$42,329,466
R	\$16,171,568
Administrative	\$74,395,003
<b>Total Received</b>	<b>\$297,406,290</b>

18 60. The distribution and servicing fee rates for the Fund have not been reduced in the  
 19 past 10 years.

20 61. As set forth above in ¶ 49, the only changes have been to raise the distribution fee  
 21 rates and impose them on share classes that had otherwise not paid them.

22 62. Furthermore, the distribution fees are based on the net asset value of the Fund and  
 23 not on the distribution activity, if any, by Defendants, such as number of shares sold.

1 Accordingly, in addition to failing to benefit the Fund and its shareholders, the Distribution Plans  
2 have extracted additional compensation for advisory services to Defendants, thereby resulting in  
3 excessive compensation received by them.

4 63. In relevant part, as the Fund has grown in size, the distribution and servicing fees  
5 have grown proportionally, reflecting a failure to pass on economies of scale to the Fund.  
6 Between 2003 and 2013, the Fund's assets under management tripled. This is essentially the  
7 same for the distribution and servicing fees. For fiscal year 2003 (ending March 31, 2004), the  
8 Fund paid just shy of \$125 million in distribution and servicing fees. Ten years later for fiscal  
9 year 2013 (ending March 31, 2014), the total distribution and servicing fees were nearly \$300  
10 million. At no time has the Fund been charged lowered distribution and servicing fees.

11 64. Morningstar has also been critical of PIMCO's distribution and servicing fee  
12 structure, and has noted that "[b]y and large, fees for [some] PIMCO . . . share classes sold  
13 through advisors or directly to investors (as opposed to institutional classes) are not  
14 competitive." Morningstar Stewardship Report at 6-7.

15 **B. Economies of Scale**

16 65. The size of the compensation received by the advisor should be evaluated in  
17 context with the economies of scale realized by a fund. Economies of scale are created when (as  
18 with the Total Return Fund) assets under management increase more quickly than the cost of  
19 advising and managing those assets. The work required to operate a mutual fund does not  
20 increase proportionately with the assets under management.

21 [I]nvestment management efforts, the most important (and most expensive) input  
22 into portfolio management, do not increase along with portfolio size. A portfolio  
23 manager can invest \$5 billion nearly as easily as \$1 billion and \$20 billion nearly  
as easily as \$10 billion. (Size may impair performance, but it imposes little  
logistical challenge.)

1 David F. Swensen, *Unconventional Success: A Fundamental Approach to Personal Investment*  
2 238 (2005). Therefore, “[a]s scale increases, fees as a percentage of assets ought to decline,  
3 allowing both fund manager and fund shareholders to benefit.” *Id.* Indeed, break points “reflect  
4 the economic reality of the direct relationship between decreasing marginal costs and increasing  
5 portfolio size.” *Id.* According to another fund industry expert, John C. Bogle, the economies of  
6 scale generated in the mutual fund portfolio management and research business are “little short  
7 of staggering.” John C. Bogle, *The Battle for the Soul of Capitalism* 154 (2005).

8 66. As an example, if a fund has fifty million dollars (\$50,000,000) of assets under  
9 management and an investment advisory fee rate of 25 basis points (100 basis points = 1%), the  
10 fee equals \$125,000 per year. A comparable mutual fund with five hundred million dollars  
11 (\$500,000,000) of assets under management would generate a fee of one million two hundred  
12 and fifty thousand dollars (\$1,250,000). Similarly, a mutual fund worth two hundred billion  
13 dollars (\$200,000,000,000) would generate an investment advisory fee of **five hundred million**  
14 **dollars (\$500,000,000) per year.**

15 67. It simply does not cost a fund advisor ten times as much to render services to a ten  
16 billion dollar (\$10,000,000,000) fund as compared to a one billion dollar (\$1,000,000,000) fund.  
17 In fact, the investment advisory services or securities selection process for a ten billion dollar  
18 fund and a one billion dollar fund are virtually identical, generating enormous economies of  
19 scale. At some point, the additional cost to advise each additional dollar in the fund (whether  
20 added by a rise in the value of the securities or additional contributions by current or new  
21 shareholders) approaches a number at or close to zero.

22 68. Even the Investment Company Institute, the national association of United States  
23 investment companies, recognizes that economies of scale exist in mutual fund management and

1 that, in part, “[m]utual fund expenses [ ] have fallen because of economies of scale.” 2014  
2 Investment Company Fact Book 87 (2014), available at  
3 [http://www.ici.org/pdf/2014\\_factbook.pdf](http://www.ici.org/pdf/2014_factbook.pdf). Further, “[l]arger mutual funds tend to have below-  
4 average expense ratios because of economies of scale.” *Id.* at 94.

5 69. The existence of economies of scale in the mutual fund industry has been  
6 confirmed by both the SEC and the Governmental Accounting Office (the “GAO”). Both  
7 conducted in-depth studies of mutual fund fees, and both concluded that economies of scale exist  
8 in the provision of advisory services. *See* SEC Division of Investment Management, Report on  
9 Mutual Fund Fees and Expenses 30-31 (Dec. 2000),  
10 <http://www.sec.gov/news/studies/feestudy.htm> (“SEC Report”); GAO, Report on Mutual Fund  
11 Fees to the Chairman, Subcommittee on Finance and Hazardous Materials; and the Ranking  
12 Member, Committee on Commerce, House of Representatives 9 (June 2000), *available at*  
13 <http://www.gao.gov/archive/2000/gg00126.pdf> (“GAO Report”).

14 70. In addition, academic research has established the existence of economies of scale  
15 that are not being passed along to mutual fund shareholders in violation of Defendants’ duty to  
16 do so under Section 36(b) and Rule 12b-1. *See* John P. Freeman & Stewart L. Brown, *Mutual*  
17 *Fund Advisory Fees: The Cost of Conflicts of Interest*, 26 J. Corp L. 609, 661 (2001) (the  
18 “Freeman & Brown Study”). As the Freeman & Brown Study noted: “The existence of  
19 economies of scale has been admitted in SEC filings made by fund managers . . . [f]und industry  
20 investment managers are prone to cite economies of scale as justification for business  
21 combinations.” *Id.* at 620.

22 71. These economies of scale exist not only on a fund by fund basis but also exist  
23 with respect to an entire fund complex and even with respect to an investment advisor’s entire

1 scope of operations, including services provided to institutional and other clients. *See id.* at 621  
2 n.62 (quoting Victoria E. Schonfeld & Thomas M.J. Kerwin, *Organization of a Mutual Fund*, 49  
3 Bus. Law 107 (1993)).

4 72. The clearest example of economies of scale occurs when total assets under  
5 management increase due purely to market forces (without the institution of new advisory  
6 relationships or new asset gathering). In such instances, as the GAO confirms, it is possible for  
7 the advisor to service the additional assets with zero additional costs. *See* GAO Report at 9  
8 (noting that growth from portfolio appreciation is unaccompanied by costs). In other words, an  
9 investment advisor can advise a fund that doubles in size purely because of market forces with  
10 no increased costs because the services are unchanged. *See id.*; Freeman & Brown Study at 619  
11 n.43, 621 (noting that investment advisors have benefited by garnering “increased fees from the  
12 general increase in market prices with no commensurate efforts on their part” and also noting  
13 that as much as 64% of mutual fund asset growth has come from appreciation of portfolio  
14 securities, which, unlike growth from share sales to new investors, is costless).

15 73. Industry insiders have also acknowledged that economies of scale exist in fixed  
16 income mutual funds such as the Total Return Fund. For example, Vanguard has stated that it  
17 “[u]se[s] economies of scale and advanced bond-trading technology to deliver low-cost  
18 investment management” with its actively managed fixed income funds. *Fixed Income Investing*  
19 *at Vanguard*, Vanguard, 7 (2009), <https://advisors.vanguard.com/iwe/pdf/FASFIXB.pdf>. *See*  
20 *also Fixed Income ETFs: The Good, The Bad and The Ugly*, ETF.com, 5 (Sept. 2012),  
21 <http://www.etf.com/docs/presentation2012/FixedIncome/FixedIncomeETFsTheGoodtheBadandtheUgly.pdf>.  
22  
23

1 74. Economies of scale also exist with regard to the provision of supervisory and  
2 administration services. Indeed, in the aggregate, various miscellaneous administrative items  
3 (aside from the transfer agency cost) typically do not account for more than three basis points of  
4 the average mutual fund's advisory fee. See John P. Freeman, Stewart L. Brown & Steve  
5 Pomerantz, *Mutual Fund Advisory Fees: New Evidence and a Fair Fiduciary Duty Test*, 61  
6 Okla. L. Rev. 83, 113 (2008) (the "Freeman, Brown, & Pomerantz Study").

7 **1. PIMCO's Economies of Scale in Investment Advisory Services**

8 75. In the case of the Fund, assets have grown dramatically over the past ten years,  
9 consequently, the investment advisory fees paid to Defendants have grown dramatically, despite  
10 the economies of scale realized by Defendants prior to the growth in assets.

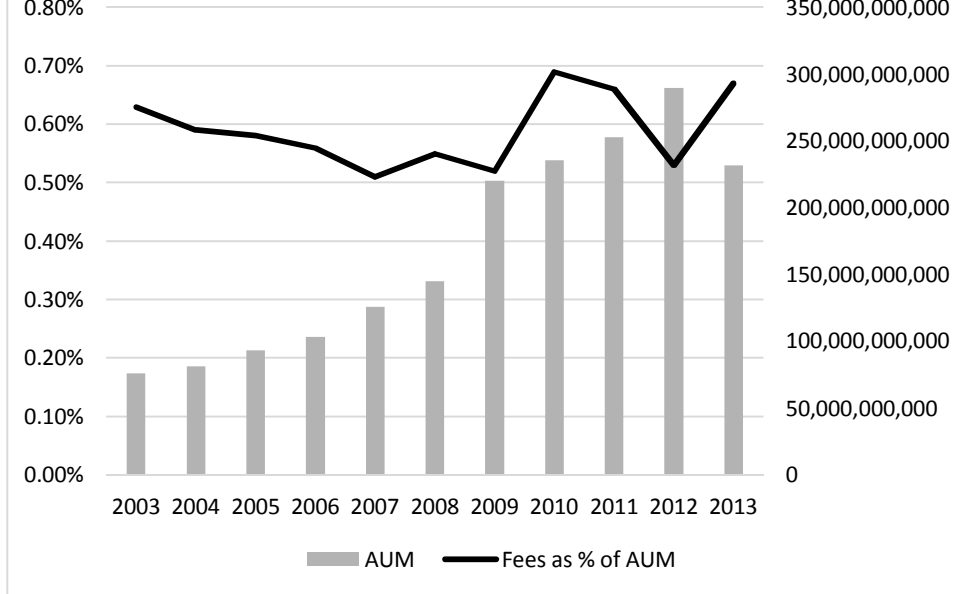
11 76. Defendants have wrongfully retained the benefits resulting from these economies  
12 of scale. These benefits can (at least in part) be shared with the Fund and its shareholders by  
13 reducing the advisory and other costs charged to the Fund by Defendants through use of fee  
14 breakpoints. For example, for each additional \$500 million invested in a fund, the advisor could  
15 charge a declining fee rate in order to share economies of scale with the shareholders. And yet,  
16 PIMCO has no breakpoints, and thus no meaningful savings have been shared with the Fund.

17 77. A review of the Fund's assets under management as compared to the fees it has  
18 paid Defendants in Chart A (below) reveals that no economies of scale have been passed to the  
19 Fund and its shareholders.





**Chart B**  
**Fees as % of AUM by Year**  
**(plotted with AUM)**



79. In March 2014, Morningstar raised a continuing concern it had with the Fund’s fees in relation to its size and the economies of scale the advisor experiences:

Even in the wake of notable redemptions in 2013, PIMCO Total Return PTTRX still comprised more than \$235 billion in investor assets as of February 2014 and remains the world’s largest actively managed mutual fund . . .

[T]he impact of Total Return’s size remains an issue that Morningstar continues to study and examine . . .

Arguably just as important to PIMCO’s Corporate Culture grade is the cost picture for investors in PIMCO’s noninstitutional share classes, in particular. Several are priced high relative to similarly structured peers and sometimes emphatically so relative to the economies of scale that the firm enjoys. It’s difficult to pin down why this issue has failed to gain more attention within PIMCO, particularly given Gross’ occasional public comments about the headwind of high fund costs—in a 2009 column he referred to 0.75% bond fund expense ratios as an “extreme absurdity.” . . .

PIMCO’s noninstitutional share classes sometimes carry fees that are simply too high to recommend, no matter how good the management. And even then, while the funds’ institutional shares are competitive on a relative basis with their various

1 cohorts, they tend to lack fee breakpoints—Total Return is a glaring example—  
2 and charge a lot more than one might expect given their size. Of all the funds in  
3 the marketplace, this enormous portfolio should by all rights boast a truly low  
4 expense ratio in its peer group. And that’s really the ultimate issue, especially for  
5 a fund group that has some of the best economies of scale of any in the world.

6 Eric Jacobson and Michael Herbst, *Morningstar’s Current View on PIMCO*, Morningstar (Mar.  
7 18, 2014),

8 <http://ibd.morningstar.com/article/article.asp?id=639535&CN=brf295>,  
9 <http://ibd.morningstar.com/archive/archive.asp?inputs=days=14;frmtId=12,%20brf295>.

10 80. Morningstar also noted the Fund Board’s failure to negotiate any breakpoints (and  
11 pass along economies of scale to the Fund) in its recent stewardship report:

12 The opacity of these data, combined with [the Fund’s] girth, suggests that the  
13 board has not done all that it can to aggressively negotiate for better economies of  
14 scale or to at least help investors better understand why the fees they pay are  
15 appropriate. That includes not only making sure that cost data are transparent but  
16 also that shareholders are getting the best deal possible for the services that are  
17 being provided.

18 These long-standing issues surrounding fee disclosure and economies of scale—  
19 PIMCO Total Return doesn’t have any management-fee breakpoints, for  
20 example—combined with newer concerns about the disruption to the funds’  
21 boards and their independence are enough to consider the current quality of the  
22 boards inferior and thus earn PIMCO a lowered Board Quality grade of D.

23 Morningstar Stewardship Report at 7.

24 **2. Defendants’ Economies of Scale in Supervisory and Administration Services**

81. PIMCO itself touts that it experiences economies of scale on its website and in its  
advertising materials. For example, PIMCO acknowledges its “substantial market presence,  
which may result in economies of scale and greater, more efficient access to opportunities.”

*PIMCO Municipal Bonds, Strategy Overview*, PIMCO, [https://managedaccounts.pimco.com/  
Pages/637.aspx](https://managedaccounts.pimco.com/Pages/637.aspx) (last visited Dec. 29, 2014). PIMCO also claims that “[a]s one of the largest  
bond managers in the U.S., we have available trading economies of scale, permitting us to

1 manage trading costs to as low a level as possible.” *National Municipal Bond Strategy*, PIMCO,  
2 <http://www.pimco.com/EN/Solutions/Pages/NationalMunicipalBond.aspx?origin=Strategies> (last  
3 visited Dec. 29, 2014). In fact, PIMCO advertises, “[o]ur municipal bond portfolios also take  
4 advantage of PIMCO’s substantial market presence, which may provide economies of scale in  
5 price and transaction costs—a benefit passed on to our clients.” *A New Paradigm for Municipal*  
6 *Investing*, PIMCO, 5 (Sept. 30, 2014), [https://investments.pimco.com/MarketingPrograms](https://investments.pimco.com/MarketingPrograms/External%20Documents/A_New_Paradigm_for_Municipal_Bond_Investing_PWP003.pdf)  
7 [/External%20Documents/A\\_New\\_Paradigm\\_for\\_Municipal\\_Bond\\_Investing\\_PWP003.pdf](https://investments.pimco.com/MarketingPrograms/External%20Documents/A_New_Paradigm_for_Municipal_Bond_Investing_PWP003.pdf).

8 82. And yet, the economies of scale generated through the provision of supervisory  
9 and administration services have not been passed to the Fund as they rightfully should. At the  
10 end of Fiscal Year 2003 the Fund had \$76 billion in assets under management, and shareholders  
11 paid a total of just over \$351 million in advisory and supervisory/administrative fees. Ten years  
12 later, at the end of Fiscal Year 2013, the Fund more than tripled in size, with over \$230 billion in  
13 assets under management, and the advisory and supervisory/administrative fees paid by the Fund  
14 to Defendants have nearly quadrupled to over \$1.24 billion.

15 83. Defendant charges the Fund shareholders anywhere from 21 to 35 basis points or  
16 seven to eleven times more than the typical cost for providing these services (three basis points).  
17 *See Freeman, Brown, & Pomerantz Study* at 113.

18 84. In a single fiscal year (2013), the Fund shareholders paid Defendant over \$600  
19 million for these administrative services alone.

### 20 3. Defendants’ Economies of Scale in Distribution and Servicing Fees

21 85. Advances in computing and communication technologies in the past twenty years  
22 have resulted in exponential efficiencies that have dramatically reduced the costs of servicing  
23 mutual funds in ways Congress could not have imagined when it enacted ICA Section 36(b).

1           86.     Despite the dramatic growth in assets Defendants manage, the fees charged for  
2 distribution and servicing have only increased. *See supra* § V.A. Accordingly, the Distribution  
3 Plan with the Distributor (PIMCO Investments LLC) has produced little or no economies-of-  
4 scale benefits to the shareholders of the Fund. Rather, the Distribution Plan has served  
5 Defendants, just as the SEC feared when it found that “the use of mutual fund assets to finance  
6 distribution activities would benefit mainly the management of a mutual fund rather than its  
7 shareholders, and therefore that such use of fund assets should not be permitted.” Bearing of  
8 Distribution Expenses by Mutual Funds, Investment Company Act Release No. 9915, 1977 WL  
9 190477 (Aug. 31, 1977). As a result, the Distribution Plan violates the intent and purpose of Rule  
10 12b-1 and is a waste of Fund assets.

11           87.     Despite the fact that Plaintiff and the other shareholders of the Fund have enjoyed  
12 no benefits from the Distribution Plan, even though they contributed to the growth of fund assets  
13 by paying distribution fees, and despite the fact that the Distribution Plan has allowed Defendant  
14 PIMCO Investments LLC to extract additional and excessive compensation from Plaintiff and  
15 other shareholders of the Fund, the Board has continued to approve, year after year, the  
16 continuation of the Distribution Plans in violation of Section 36(b). In turn, Defendants have  
17 reaped additional and excessive compensation while failing to pass on any savings from  
18 economies of scale they experience to the Fund, Plaintiff, or the other Fund shareholders.

### 19     **C.     Comparative Fee Structure**

20           88.     “In order to determine whether a fee is excessive for purposes of Section 36(b), a  
21 court must examine the relationship between the fees charged and the services rendered by the  
22 investment adviser.” *Krantz v. Prudential Inv. Fund Mgmt., LLC*, 305 F.3d 140, 143 (3d Cir.  
23 2002) (citations omitted). To facilitate this comparison, Plaintiff compares the Fund’s fees to

1 fees charged by the Defendants to three other PIMCO clients: PIMCO's private clients, Harbor  
2 Capital Advisor's Harbor Bond Fund sub-advised by PIMCO, and the PIMCO Total Return  
3 Fund ETF. All three of these comparators present the "range of fees" that might result from  
4 arm's-length bargaining and present a benchmark for reviewing the compensation received by  
5 PIMCO for the Fund. *See Jones*, 559 U.S. at 347 (citing *Gartenberg*, 694 F.2d at 929).

6 **1. Rates charged by PIMCO to Private Clients**

7 89. A mutual fund is a single client relationship for the Defendants, as with any other  
8 institutional client. Accordingly, with respect to the advisory and supervisory and administrative  
9 fees, a mutual fund is no different from any other institutional investor.

10 90. The investment advisory services Defendants provide to the Fund are simple to  
11 summarize: Defendants buy and sell, at their discretion, securities for the funds.

12 91. Morningstar has concluded that there should be no difference between  
13 management fees charged to mutual funds (retail products) and other institutional clients:

14 Fees for a firm's retail products should not be materially different from  
15 management fees for a firm's institutional offerings. Though we appreciate the  
16 added costs of servicing small accounts, those expenses needn't show up in the  
17 management fees.

18 Kunal Kapoor, *A High Hurdle: Our Criteria for Picking Funds*, Morningstar (Dec. 4, 2003),  
19 <http://news.morningstar.com/articlenet/article.aspx?id=100812>.

20 92. Defendants provide investment advisory services to a variety of private clients  
21 outside of those who invest in the Fund or the Fund Complex. The same portfolio managers of  
22 the Total Return Fund also provide private investors who have at least \$75 million the  
23 opportunity to invest in essentially the same fund with lower fees charged. *See* 2013 SAI, at

1 88-91.<sup>7</sup> To such investors, PIMCO provides access to invest in a “Total Return” fund that, on  
2 information and belief, contains the same or substantially similar underlying investments as  
3 those that compose the Fund. *Compare* PIMCO Form ADV Part 2A Brochure 2014 at 38 *with*  
4 PIMCO Funds, Prospectus, at 28 (July 31, 2014).

5 93. Defendants charge these private investors much lower fee rates than Plaintiff and  
6 the Fund pay for the same investment advisory services. Moreover, unlike the Fund, PIMCO  
7 offers significant breakpoints in their fee rates for these clients. That is, PIMCO recognizes and  
8 shares the economies of scale with these private investors, a practice that it does not employ with  
9 the Fund and the Fund’s shareholders. Private investors may select between two fee schedules:  
10 (1) a fixed fee or (2) performance fee. PIMCO Form Adv. Part 2A Brochure 2014 at 33. Under  
11 the “fixed fee” schedule, the investor must invest at least \$75 million. The investor then pays  
12 PIMCO a fee of 0.50% on the first \$25 million, 0.375% on the next \$25 million and then 0.25%  
13 on all amounts over \$50 million in the investor’s account. These breakpoints are significant. A  
14 private investor with \$100 million to invest may elect to pay a performance fee that has a “Base  
15 Fee” of 0.15% plus a payment of 15% of any “outperformance over the applicable index plus the  
16 Base Fee.” PIMCO Form Adv. Part 2A Brochure 2014 at 33.

17 94. The favorable rates incorporating breakpoints that private investors enjoy produce  
18 huge savings relative to what shareholders in the Fund pay in annual fees. A simple example  
19 illustrates this point. A private investor who invests \$200 million in a private Total Return  
20 account pays \$593,750 in annual fees to PIMCO (using the fixed fee schedule). Yet an investor  
21 with \$200 million in A Class shares in the Fund will pay **\$1.7 million** in annual fees, while a  
22

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23 <sup>7</sup> These accounts are reported as “Other Accounts,” and only the number of such accounts and the total assets of all  
such accounts are reported.

1 person investing \$200 million in either B or C Class shares in the Fund will pay a whopping **\$3.2**  
2 **million** in annual fees. Even an investor in the Fund’s “Institutional” share class who invests  
3 \$200 million will still pay \$920,000 in annual fees—nearly twice what a private investors will  
4 pay under the fixed fee schedule. Upon information and belief, the underlying investments for  
5 both private investors and Fund shareholders are not materially different and the nature and  
6 quality of the investment services Defendants provide are indistinguishable. Yet, investors in the  
7 Fund pay an unjustifiably larger amount to Defendants because they enjoy no economies of  
8 scale, including, for example, no breakpoints.

9 95. Unlike Plaintiff and investors in the Fund, these private clients have the ability to  
10 negotiate at arm’s length—a luxury not afforded to Plaintiff and the Fund’s shareholders. This  
11 permits private investors to enjoy even greater savings relative to what shareholders in the Fund  
12 pay in fees.

13 96. PIMCO discloses that under either the fixed fee or the performance fee, the  
14 private investor can negotiate the fees “under certain circumstances” that it does not explain  
15 further. PIMCO Form Adv. Part 2A Brochure 2014 at 33.

16 97. Under either the fixed fee or performance fee schedule, private investors receiving  
17 the same investment advisory services pay substantially less than Fund shareholders. If one  
18 excludes distribution and servicing fees, *Fund shareholders are paying between two and three*  
19 *times as much as private investors*. If one includes the distribution fees, *Fund shareholders are*  
20 *paying between two and five times as much as private investors for the same services*. And none  
21 of the Fund shareholders receive breakpoints. Nor do they have the ability to negotiate the fees.

1           **2. Rates charged by PIMCO for sub-advising the Harbor Bond Fund**

2           98. The Harbor Bond Fund, a bond fund with a “total return” investment goal, is  
3 offered by Harbor Capital Advisors, Inc. to investors. The board of trustees who oversees the  
4 Harbor Bond Fund oversees 29 funds in their complex and have eight independent trustees  
5 overseeing the funds, with only one additional insider trustee.

6           99. Defendant PIMCO provides sub-advisory services to the Harbor Bond Fund. In  
7 fact, until he left PIMCO, Bill Gross sub-advised the Harbor Bond Fund since its inception in  
8 1987.<sup>8</sup> When asked at an interview about the difference between the Harbor Bond Fund and the  
9 Total Return Fund, Gross responded, “There’s not much difference at all, other than size and  
10 fees.” *Bill Gross: Harbor Bond Fund*, Bloomberg Businessweek (Mar. 29, 2006),  
11 [http://www.businessweek.com/stories/2006-03-29/bill-gross-harbor-bond-fundbusinessweek-](http://www.businessweek.com/stories/2006-03-29/bill-gross-harbor-bond-fundbusinessweek-business-news-stock-market-and-financial-advice)  
12 [business-news-stock-market-and-financial-advice.](http://www.businessweek.com/stories/2006-03-29/bill-gross-harbor-bond-fundbusinessweek-business-news-stock-market-and-financial-advice)

13           100. The PIMCO Total Return Fund has had the same portfolio manager (Gross) and  
14 virtually identical performance to the Harbor Bond Fund. Yet, the PIMCO Total Return Fund  
15 shareholders paid vastly more compensation for investment advisory services. PIMCO accepts  
16 23 basis points for sub-advising the Harbor Bond Fund, while charging all Fund shareholders 25  
17 basis points for the investment advising it provides the Fund. Moreover, Harbor Bond Fund  
18 Institutional Class shareholders pay only 53 basis points for all services compared to 85 basis  
19 points that Class A shareholders of the Total Return Fund pay, and that the 160 basis points  
20 Class B and C shareholders pay to Defendants.

21  
22 <sup>8</sup> After Gross left PIMCO, PIMCO has continued to be the subadvisor to the Harbor Bond Fund. Mssrs. Kiesel,  
23 Mather, and Worah, the same PIMCO executives who are the portfolio managers of the Fund, took over as the  
24 portfolio managers to the Harbor Bond Fund. Harbor Bond Fund Supplement to Summary Prospectus dated March  
1, 2014, at 1 (Sept. 29, 2014).



1           101. In addition, a \$10,000 investment is all that is required to purchase the  
2 Institutional Class of the Harbor Bond Fund (which has significantly lower fees) but a \$1 million  
3 minimum investment is required to purchase the Institutional Class of the Total Return Fund.  
4 Moreover, unlike the Class A shareholders of the Fund, the Harbor Bond Fund does not charge a  
5 load fee.

6           102. As evidence of the excessive compensation received by PIMCO for the Total  
7 Return Fund, PIMCO was willing to accept compensation of \$17 million annually for providing  
8 investment advisory services for a similar portfolio (the Harbor Bond Fund) with similar  
9 investment returns, and the same investment managers (Bill Gross, and his three successors once  
10 Gross left PIMCO) while charging its own Fund shareholders over \$641 million for investment  
11 advisory services.

12           103. For this reason, analysts were recommending an investment in Harbor Bond Fund  
13 rather than the Total Return Fund as early as July 2010:

14           [The Total Return Fund’s fees are] on the high side for many retail investors.  
15           There are plenty of smaller, nimbler and cheaper alternatives. The Harbor Bond  
16           Fund—which is subadvised by PIMCO—is managed by Mr. Gross in the same  
              fashion yet is cheaper and boasts one of the best records in the intermediate-term  
              bond category, according to Morningstar.

17           Jane Kim, *Pimco: Too Big to Do Battle?* Wall St. J., July 31, 2010, <http://www.wsj.com/articles>  
18           /[SB10001424052748704895004575395441645631572](http://www.wsj.com/articles/SB10001424052748704895004575395441645631572).

19           **3. Rates charged by PIMCO to the Total Return Active Exchange-Traded Fund**

20           104. In March 2012, Defendants started offering the PIMCO Total Return Active  
21 Exchange-Traded Fund which was designed to resemble the flagship Total Return Fund, such  
22 that it offers a “diversified portfolio of high quality bonds that is actively managed in an effort to  
23

1 maximize return in a risk-controlled framework.” An ETF, or exchange-traded fund, trades  
2 throughout the trading day, and does not have any investment minimum or sales loads.

3 105. The PIMCO Total Return Active ETF (“ETF”) has a total expense ratio of 55  
4 basis points compared to 85 basis points for Class A shares of the Fund and 160 basis points for  
5 Class B and C shares of the Fund.

6 106. The ETF and the Fund resemble each other in two key respects: both funds were  
7 run by Gross, and they both had the same broad asset allocations. *See* Stan Luxenberg, *Pimco’s*  
8 *Flagship Mutual Fund Trails the New ETF*, TheStreet (July 20, 2012), [http://www.thestreet.com/](http://www.thestreet.com/story/11629935/1/pimcos-flagship-mutual-fund-trails-the-new-etf.html)  
9 [story/11629935/1/pimcos-flagship-mutual-fund-trails-the-new-etf.html](http://www.thestreet.com/story/11629935/1/pimcos-flagship-mutual-fund-trails-the-new-etf.html).

10 107. And as evidence of the excessive compensation received by PIMCO for the Total  
11 Return Fund, PIMCO was willing to accept compensation of \$20 million (for fiscal year ending  
12 June 30, 2014) annually for managing and advising a similar portfolio (the Total Return Active  
13 ETF) with similar investment returns, and the same investment managers (Bill Gross and his  
14 three successors) while charging its own Fund shareholders over \$1.2 **billion** for investment  
15 advisory and administrative and supervisory services.

16 108. These three fee comparators (PIMCO’s private clients, the sub-advised Harbor  
17 Bond Fund, and the PIMCO Total Return Active ETF) establish that the Defendants are charging  
18 advisory, supervisory and administrative, distribution, and servicing fees to the Fund that are  
19 excessive and disproportionate to the value of the services rendered and not within the range of  
20 fees that might result from arm’s-length bargaining. This violates Section 36(b) of the ICA.

21 **D. The Nature And Quality Of The Services Provided To The Fund’s Shareholders**

22 109. The nature of the advisory and distribution services provided to the Fund is  
23 straightforward: Defendants select (buy, sell or hold), at their discretion, short-term instruments,

1 corporate bonds and notes, U.S. Treasury obligations, U.S. Government agencies, sovereign  
2 issues, mortgage-backed securities, and other investments for the Fund and attempt to garner  
3 new shareholders of the Fund. This is precisely the same set of services provided to Defendants'  
4 other clients even though the Fund is charged dramatically higher fees. *See supra* § V.C.

5 110. As set forth above, the nature of the advisory services provided to the Fund has  
6 been very poor recently. In 2012, the Fund failed to outperform its benchmark, and 60% of the  
7 Fund's peers outperformed the Fund. In Calendar Year 2013, the Fund performed terribly. For  
8 example, shareholders in Class A of the Fund saw returns of -5.97% before taxes, while  
9 shareholders of Class B shares saw returns of -6.36% before taxes. *See supra* ¶ 36.

10 111. Nevertheless, Plaintiff and other shareholders of the Fund pay Defendants higher  
11 percentage fees and dramatically higher absolute dollar fees because the Board has failed to  
12 negotiate any reduction in the fees. The fees paid by the Fund are not even close to the range of  
13 fees produced by the arm's-length negotiations with the Defendants' other clients.

14 112. Moreover, the nature of the administrative and distribution services provided to  
15 the Fund does not justify the higher fees; it is the size of the fund, not its specialized nature, that  
16 determines a fair fee:

17 We disagree with the premise that specialized fund strategies should result in  
18 higher expense ratios. Though we will make accommodations to reflect the higher  
19 costs inherent in running a smaller fund, we don't think funds of the same size  
20 ought to be charging materially different expenses.

21 Kunal Kapoor, *A High Hurdle: Our Criteria for Picking Funds*, Morningstar (Dec. 4, 2003).

22 113. No accommodations need be made for the Defendants based on the "higher costs  
23 inherent in running a smaller fund," since the Fund was until recently the largest in the world.  
24 *See id.* The reverse is true: accommodations for the benefit of the shareholders must be made to  
reflect the far lower costs in running a larger fund. No such accommodations were made by the

1 Defendants. Moreover, the cost of servicing the accounts of larger private clients is often far  
2 more expensive than servicing smaller investor's accounts—investors who command far less  
3 time of the investment advisor and its affiliates.

4 114. Further, any ancillary “customer service” services Defendants purport to be  
5 providing to the Fund under the guise of the “supervisory and administrative,” or “distribution  
6 and servicing” fees is illusory.

7 115. While the compensation Defendants receive pursuant to its contracts with the  
8 Fund is extraordinary, the services they provide to Fund shareholders, such as Plaintiff, are poor.  
9 In his dealings with Defendants, Plaintiff has routinely encountered unacceptable service and  
10 inadequate access to information about his account. Examples of the problems Plaintiff has  
11 encountered include:

12 A. PIMCO reported to Plaintiff a personal rate of return for Plaintiff's  
13 investment in the Fund, which varied from the return rates of other family accounts in the  
14 Fund, and from the published return rates for the Fund. Given the lack of clarity as to the  
15 rates of return, Plaintiff called PIMCO for an explanation, but PIMCO could not  
16 satisfactorily explain the differences.

17 B. PIMCO failed to synchronize account value information and daily net  
18 asset value for the Fund on PIMCO's website. This absence of an effective date for  
19 account balances created confusion regarding for what day the account value was being  
20 reported, i.e., whether for the prior trade day or the current trade day. Plaintiff called  
21 PIMCO and was told that PIMCO could not add an “effective date” to the reported  
22 account balances on the PIMCO website. Plaintiff suggested that, during the upcoming  
23

1 redesign of the website, PIMCO should report the “effective date” of account balances  
2 and was told it could not be done.

3 C. Plaintiff has been unable to access his account due to server problems at  
4 PIMCO at least 8 separate times in the past 12 months. Plaintiff has also frequently  
5 encountered webpages that cannot be accessed due to errors within PIMCO’s control.  
6 Error messages have often not been germane or have been unclear, regarding the nature  
7 of the website problem.

8 D. Plaintiff has been unable to consistently access full account history online  
9 for all accounts. Moreover, how far back in time Plaintiff could access his transaction  
10 history has varied from account to account, even though the date all accounts were  
11 opened is the same across all accounts. In the latter case, PIMCO indicated that this  
12 variability resulted from the retroactive correction of their prior errors, i.e., the  
13 assignment of current-year “confirm dates,” when PIMCO retroactively corrected  
14 previous-year(s) trades.

15 E. PIMCO has routinely failed to process Plaintiff’s transaction requests in a  
16 timely manner, in the manner Plaintiff has requested, and in a manner that PIMCO  
17 assured Plaintiff they would be handled, and has, at times, assigned incorrect trade dates.

18 F. PIMCO has routinely failed to process required minimum distributions in  
19 a timely manner, despite Plaintiff’s timely requests, repeated follow-up conversations,  
20 and assurances from PIMCO employees.

21 G. Despite Plaintiff’s specific instructions, PIMCO has issued and mailed, or  
22 planned to issue and mail, dividend distributions or required minimum distributions via  
23

1 checks, despite Plaintiff's specific, even written, instructions and PIMCO's agreement to  
2 send distributions via electronic, ACH, bank transfers.

3 H. PIMCO has also routinely failed to process tax-year recharacterizations of  
4 Roth IRA conversions in a timely manner and to communicate recharacterization  
5 deadlines properly. PIMCO entered incorrect trade dates for a number of  
6 recharacterizations in 2011, 2012, and 2013. Moreover, PIMCO in a number of instances  
7 failed to provide correct tax forms and tax reporting information, or to correctly indicate  
8 the calendar tax year to which a transaction would apply and within which it would be  
9 reported.

10 I. PIMCO's failure to process transactions according to Plaintiff's requests  
11 has caused Plaintiff to spend innumerable hours trying to correct PIMCO's errors, despite  
12 assurances from PIMCO employees that corrections would be timely and accurately  
13 made. In 2013 alone, Plaintiff contacted PIMCO approximately 16 times to correct trade  
14 dates of transactions and recharacterizations. And in 2012, when Plaintiff contacted  
15 PIMCO to correct certain transaction dates and amounts, a PIMCO representative in its  
16 adjustment team admitted PIMCO has not properly managed transactions and earnings.  
17 The representative told Plaintiff "I don't blame you for not trusting that PIMCO is  
18 handling any transactions, including earnings, correctly."

19 J. PIMCO did not provide Plaintiff and other Fund shareholders with timely  
20 information about Bill Gross's sudden and unexpected departure from PIMCO and who  
21 would thereafter be managing the Fund. Although Bill Gross was widely reported to have  
22 left PIMCO on September 26, 2014, Plaintiff received no mailed notice or explanation  
23 from PIMCO. Plaintiff only received PIMCO's notice of this information when logging

1 into his PIMCO account on October 13, 2014, and reading a separate PIMCO webpage  
2 containing a supplemental notice to shareholders about Bill Gross's departure and who  
3 would be managing the Fund.

4 **E. The Profitability Of The Fund**

5 116. The profitability to the Defendants of managing the Fund is a factor that must also  
6 be considered when evaluating whether the compensation received by Defendants is excessive.

7 117. Intuitively, it is obvious that the fees charged to other clients in arm's length  
8 negotiations represent profitable transactions, *see, e.g., supra* at § V.C (observing that  
9 Defendants charge far less to clients other than the Fund for the same services). Otherwise,  
10 investment managers (such as the Defendants) intending to stay in business would be required to  
11 charge a higher fee. Accordingly, it is obvious that the management of the Fund (paying much  
12 higher advisory, supervisory and administrative, distribution and servicing fees than other  
13 clients) is highly profitable to the Defendants.

14 118. Public filings further indicate that the Board is aware that the profitability of the  
15 Fund is outside when compared to other (captive) mutual funds in the industry. The September  
16 30, 2014, Semiannual Report for the PIMCO Total Return Fund stated that "profit margins were  
17 within the ranges, *although above the median*, of publicly held investment management  
18 companies reported by Lipper and Strategic Insight (an independent provider of fund industry  
19 research)" (emphasis added).

20 119. "Profitability" is a function of revenues minus the costs of providing services.  
21 Although simple in definition, it is very problematic in practice in the mutual fund industry  
22 because of questionable cost accounting practices.

1           120. Here, the PIMCO Defendants are subsidiaries of a foreign public company,  
2 Allianz, and precise information regarding the actual or claimed profitability of the Fund to  
3 Defendants is not available except through discovery, even if it were maintained in an accurate  
4 and useable format. *See Krantz v. Fidelity Mgmt. & Research Co.*, 98 F. Supp. 2d 150, 159 (D.  
5 Mass. 2000).

6           121. One thing that is clear, however, is that where profitability is concerned, size  
7 matters. There are higher cost ratios inherent in running a smaller fund and, conversely, lower  
8 cost ratios in running a larger fund. The Total Return Fund was until recently the largest mutual  
9 fund in the world and, accordingly, should be one of the least expensive in the world to advise on  
10 the basis of costs divided by assets. This is not the case. The Fund’s fees have grown at the same  
11 rate as the underlying assets in the Fund have grown and Defendants have not meaningfully  
12 lowered any fees they charge the Fund in the last 10 years.

13           122. Even without complete data, it is clear that one of the world’s largest mutual  
14 funds is astoundingly profitable. The Total Return Fund alone poured over \$1.5 billion into  
15 Defendants’ coffers through a variety of fees in just a single year—the fiscal year ending March  
16 31, 2014. Of that, as much as \$640 million was for pure advisory services. In contrast, in fiscal  
17 year 2003, the same advisory services were “only” \$185 million when the Fund was roughly half  
18 the size it was in fiscal year 2013. The payment and receipt of such a dramatic increase in fees  
19 for pure advisory services while managing comparable (but much smaller) portfolios for a much  
20 smaller fee is a breach of Defendants’ fiduciary duty to the Fund and its shareholders, including  
21 Plaintiff.

22           123. Similarly, for fiscal year 2013, the Fund paid \$608 million in “supervisory and  
23 administrative fees,” while the Fund paid “only” \$165.8 million for the same services in fiscal



1 year 2003. Upon information and belief, the true cost of these “supervisory and administrative”  
2 services have not tripled in 10 years. The payment and receipt of such a dramatic increase in fees  
3 for these services while not actually incurring costs that come anywhere close to the three-fold  
4 increase in fees charged is a breach of Defendants’ fiduciary duty to the Fund and its  
5 shareholders, including Plaintiff.

6 **F. Fallout Benefits (Indirect Profits) To Defendants Attributable To The Fund**

7 124. Fallout benefits include the attraction of new customers *for other funds or*  
8 *products offered by the Defendants*, cross-selling Defendants’ other funds and services to current  
9 shareholders of the Fund, and other benefits associated generally with the development of  
10 goodwill and the creation and growth of a client base for the Defendants.

11 125. For example, in addition to offering over 150 mutual funds, PIMCO states on its  
12 website that it “provides investment solutions in a variety of vehicles for individual investors and  
13 the financial intermediaries they work with,” and then recommends that individual investors  
14 check out their mutual fund and ETF websites for more information, and suggests that high-net-  
15 worth investors seek out their “PIMCO separate accounts.”

16 126. PIMCO also stated in its September 30, 2104, Semiannual Report for the PIMCO  
17 Total Return Fund that “other benefits” received by PIMCO and its affiliates as a result of  
18 PIMCO’s relationship with the Trust include “possible ancillary benefits to PIMCO’s  
19 institutional investment business.”

20 127. Brokerage commissions payable by the Fund to the Defendants (or their affiliates)  
21 constitute another fallout benefit. These commissions are paid, as securities are bought and sold  
22 at the Defendants’ direction for the Fund. PIMCO states on its website that it has introduced “a  
23

1 fully integrated investment solutions and distribution platform in the US in order to enhance our  
2 partnership with financial advisors.”

3 128. The Defendants indirectly profit because of “fallout benefits” attributable to the  
4 Fund. Fallout benefits are often not quantified by the Defendants or shared with the Board even  
5 though the Board cannot determine the fairness of any fee without having this information.

6 129. Fallout benefits are required to be disclosed to the Fund’s Board of Trustees as  
7 part of the total mix of information necessary to determine the reasonableness of the fees. Even  
8 without considering the fallout benefits, the fees are excessive in both the rate and total  
9 compensation the fees generate. After considering the fallout benefits, the advisory, supervisory  
10 and administrative, distribution and servicing fees are huge and their payment and receipt  
11 violates Section 36(b) of the ICA.

## 12 **G. The Independence And Conscientiousness Of The Trustees**

### 13 **1. Role of Independent Trustees Under Legal and Regulatory Framework**

14 130. As required by the ICA, all of the fees paid to Defendants must be approved by  
15 the Fund’s Board on an annual basis.

16 131. As a fiduciary, the Board is charged with ensuring that all of the fees paid are  
17 reasonable and in the best interest of the Fund. Under the ICA, the majority of the trustees are to  
18 be “disinterested” requiring that they oversee the fees charged with an eye solely to the benefit of  
19 the Fund and its shareholders. Respected industry expert, Morningstar, recommends that a board  
20 be comprised of at least 75% disinterested trustees. Morningstar Stewardship Report at 5.

21 132. The disinterested directors (or trustees) are supposed to serve as “watchdogs” for  
22 the shareholders of the Fund. As such, the disinterested directors have primary responsibility for,  
23 among many other things, negotiating and approving all agreements with Defendants and

1 reviewing the reasonableness of the fees received by Defendants. Accordingly, as noted by the  
2 GAO, the directors are expected to review, among other things, the adviser's costs, whether fees  
3 have been reduced when the Fund's assets have grown, and the fees charged for similar services.  
4 *See* GAO Report at 14. These responsibilities necessarily require the directors to rely on  
5 information provided by Defendants. Defendants, in turn, have a fiduciary duty to provide all  
6 information reasonably necessary for the directors to perform their obligations.

7 133. As the GAO Report noted, the "external management" structure of most mutual  
8 funds (including the Fund) creates a potential conflict of interest between a fund's shareholders  
9 and its adviser. The United States Supreme Court has characterized the disinterested director  
10 requirement as "the cornerstone of the ICA's efforts to control" this conflict of interest. *Burks v.*  
11 *Lasker*, 441 U.S. 471 (1979).

12 134. The SEC has specifically recognized however, that even disinterested directors  
13 may not be independent but, rather, subject to domination or undue influence by a fund's  
14 investment adviser. For example, in the related context of distribution fees, "disinterested  
15 directors should not be entrusted with a decision on use of fund assets for distribution without  
16 receiving the benefit of measures designed to enhance their ability to act independently." *Bearing*  
17 *of Distribution Expenses by Mutual Fund, Investment Co. Act Rel. No. 11414, 1980 WL 20761,*  
18 *at \*11 (Oct. 28, 1980).*

19 135. Despite the structural protections of independent directors envisioned by the  
20 Investment Company Act, the Fund's trustees have been subverted by Defendants and no longer  
21 serve in their "watchdog" role. This subversion was (and remains) a breach by the Defendants of  
22 the fiduciary duties owed to the Fund.

1           **2.     The Compensation Structure for the PIMCO Board Leads to Lack of**  
2           **Independence**

3           136.    Until the Spring 2014, the Board had only seven trustees total (two interested  
4 trustees and five “independent” trustees). The Board now has only five trustees (two interested  
5 and three “independent” trustees) after one trustee resigned and the other was removed. The  
6 Board meets periodically throughout the year to oversee all funds in the Fund Complex.

7           137.    During the fiscal year ending March 31, 2014, the members of the Board  
8 simultaneously oversaw between 167 to 175 portfolios/funds that make up the Fund Complex.

9           138.    The trustees are compensated handsomely for their services with a fee based on a  
10 schedule that takes into account an annual retainer, special retainers for committee chair  
11 positions, the number of meetings attended, and expenses incurred. Each of the independent  
12 trustees is paid an annual retainer of \$145,000, a \$15,000 retainer to the Audit Committee  
13 chairman and a \$2,250 retainer to the Governance Committee chairman. The trustees are also  
14 paid \$15,000 for each Board meeting they attend in person, \$750 for each committee meeting  
15 attended (\$2,000 to the Audit Committee chair), and \$1,500 for each Board meeting attended  
16 telephonically, plus reimbursement of related expenses.

17           139.    For the fiscal year ending March 31, 2014, the independent trustees for the funds  
18 in the Fund Complex received total compensation in the following amounts:

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20           ///

21           ///

22           ///

23           ///

Trustee	2013	
	The PIMCO Trust	Fund Complex
E. Philip Cannon	\$209,500	\$417,050
J. Michael Hagan	\$203,250	\$306,050
Ronald C. Parker	\$224,500	\$339,800
Vern O. Curtis*	\$209,500	\$341,675
William J. Popejoy*	\$211,750	\$322,300

(\* no longer on board and not replaced). *See* 2013 SAI at 71.

140. On information and belief because the precise number of Board meetings are not directly published, Trustee Parker attended three full Board meetings in person and four telephonically, Trustee Hagan attended three full Board meetings in person and four telephonically, and Trustee Cannon attended four full Board meetings in person. For their services in Fiscal Year 2013, Trustee Cannon earned \$209,500 from the Trust, Trustee Hagan earned \$203,250 from the Trust, and Trustee Parker earned \$224,500 from the Trust. These same trustees provided services to other PIMCO-related trusts, which bumped the total compensation for Trustee Cannon to \$417,050, for Trustee Hagan to \$306,050, and for Trustee Parker \$339,800. The two out-going interested trustees also earned substantial sums: Mr. Popejoy was paid \$211,750 in aggregate compensation from the Trust and Mr. Curtis earned \$209,500 in aggregate compensation from the Trust.

141. As a result, board membership in the Fund Complex is a lucrative part-time job, the continuation of which is dependent (at least in part) on the continued good will and support of Defendants, as demonstrated by the ouster of Trustee Popejoy after he criticized Gross. *See*

1 *infra* ¶ 144. Thus, the compensation structure for the Board threatens the independence of the  
2 trustees.

3 **3. The Composition of the PIMCO Board Leads to Lack of Independence and**  
4 **Conscientiousness**

5 **a. PIMCO Board Lacks a Sufficient Number of Independent Trustees**

6 142. The Board's ability to oversee and review the amount of compensation being paid  
7 by the Fund is deficient in light of the very few disinterested trustees on the Board. Morningstar  
8 has "faulted the board for having just five independent trustees among the total of seven—less  
9 than the three-quarters majority it said was a best practice for mutual fund boards." E. Scott  
10 Reckard, *Morningstar Cuts PIMCO Fund Rating from Gold to Bronze After Gross Exit*, L.A.  
11 Times, Sept. 30, 2014, [http://www.latimes.com/business/la-fi-morningstar-downgrades-pimco-](http://www.latimes.com/business/la-fi-morningstar-downgrades-pimco-20140930-story.html)  
12 [20140930-story.html](http://www.latimes.com/business/la-fi-morningstar-downgrades-pimco-20140930-story.html).

13 143. As of March 20, 2014, Morningstar rated PIMCO a "C" for Board Quality. 2014  
14 Morningstar U.S. Mutual Fund Industry Stewardship Survey, Morningstar, 39 (Mar. 20, 2014),  
15 <http://corporate.morningstar.com/us/documents/MethodologyDocuments/ResearchPapers/Mutual>  
16 [FundIndustryStewardship.pdf](http://corporate.morningstar.com/us/documents/MethodologyDocuments/ResearchPapers/Mutual). However after two of the five independent trustees abruptly  
17 resigned, Morningstar further downgraded the Fund to a "D," for "Fund Board Quality" meaning  
18 that the Board was "trailing the industry norms." Morningstar captured the problems with the  
19 Board succinctly:

20 When there is turmoil at a fund company, it is especially important to have an  
21 effective board in place. Yet the PIMCO boards themselves are in some turmoil.  
22 Continued disruption among PIMCO's independent trustees raises significant  
23 concern about the board's independence as well as its long-established setup.  
More specifically, two of the PIMCO Funds Trust's five independent trustees,  
William Popejoy and Vern Curtis, recently left the board (as well as the Variable  
Insurance Trusts and ETF Trust), *leaving its composition at just three independent*  
*trustees and two interested trustees and at just 60% independent.* This level falls

1 short of industry norms; most fund boards are at least 75% independent (emphasis  
2 added).

3 Morningstar Stewardship Report at 5.

4 144. Of the two independent trustees who left the Board, it appears that 23-year Board  
5 veteran, William Popejoy, was forced to resign after butting heads with Bill Gross. “Southern  
6 California businessman William J. Popejoy, had departed the board under unexplained  
7 circumstances earlier this year after criticizing Gross’s \$200 million salary and ‘bullying’  
8 management style in an interview with [L.A.] The Times.” E. Scott Reckard, *Morningstar Cuts*  
9 *PIMCO Fund Rating From Gold to Bronze After Gross Exit*, L.A. Times, Sept. 30, 2014,  
10 <http://www.latimes.com/business/la-fi-morningstar-downgrades-pimco-20140930-story.html>.  
11 “According to a midsummer regulatory filing by the funds, Popejoy resigned as one of the funds’  
12 seven trustees. But a later revision of the filing deleted the ‘resigned’ language, showing only  
13 that Popejoy no longer was a trustee.” E. Scott Reckard, *Longtime trustee of Pimco mutual funds*  
14 *appears to have lost his job*, L.A. Times, Sept. 2, 2014, [http://www.latimes.com/business/la-fi-](http://www.latimes.com/business/la-fi-popejoy-pimco-20140903-story.html)  
15 [popejoy-pimco-20140903-story.html](http://www.latimes.com/business/la-fi-popejoy-pimco-20140903-story.html); compare 2013 SAI at 71 (July 31, 2014) with 2013 SAI at  
16 71 (July 31, 2014 as supplemented Aug. 25, 2014). “Popejoy later told The Times that he had  
17 disagreed with the chairman of the board, PIMCO executive Brent Harris, over the makeup of  
18 the board, with Popejoy saying it should have women and minorities instead of just white men.”  
19 E. Scott Reckard, *Morningstar Cuts PIMCO Fund Rating From Gold to Bronze After Gross Exit*,  
20 L.A. Times, Sept. 30, 2014, [http://www.latimes.com/business/la-fi-morningstar-downgrades-](http://www.latimes.com/business/la-fi-morningstar-downgrades-pimco-20140930-story.html)  
21 [pimco-20140930-story.html](http://www.latimes.com/business/la-fi-morningstar-downgrades-pimco-20140930-story.html). He also called for PIMCO’s parent, Allianz SE, to investigate  
22 Gross’s compensation and management ability and publicly criticized Gross’s compensation as  
23 “not appropriate.” *Id.*

1 145. As of the date of filing, neither independent trustee has been replaced on the  
2 Board. This has left the Board without sufficient independence to ensure the fee agreements with  
3 Defendants are negotiated in the best interest of the Fund and its shareholders.

4 **b. Interested Trustees Control the PIMCO Board**

5 146. Even if statutorily disinterested, the trustees are in all practical respects dominated  
6 and unduly influenced by Defendants in reviewing the fees paid by Plaintiff and other  
7 shareholders of the Fund.

8 147. First, Morningstar has criticized the Board overseeing the bond funds for having  
9 PIMCO Executive Brent Harris head the Board rather than an independent trustee. E. Scott  
10 Reckard, *Morningstar Cuts PIMCO Fund Rating From Gold to Bronze After Gross Exit*, L.A.  
11 Times, Sept. 30, 2014, [http://www.latimes.com/business/la-fi-morningstar-downgrades-pimco-](http://www.latimes.com/business/la-fi-morningstar-downgrades-pimco-20140930-story.html)  
12 [20140930-story.html](http://www.latimes.com/business/la-fi-morningstar-downgrades-pimco-20140930-story.html).

13 148. Second, the lack of independence was aired publicly in the firing of Mr. Popejoy  
14 after he had criticized PIMCO's CEO and CIO, Gross, and the compensation he earned from the  
15 Fund and Fund Complex. This is further evidenced by the exceptional fact that two long-time  
16 trustees left in 2014. Rarely do trustees to mutual funds abandon such lucrative part-time work,  
17 and in the case of Mr. Popejoy it is clear he did not resign.

18 149. Third, by industry standards, the Board has been woefully understaffed with  
19 independent trustees. *See Morningstar Stewardship Report*, at 5. The Board lacks a sufficient  
20 number of independent trustees to conscientiously manage all of the funds in the Fund Complex  
21 that the Board oversees.

22 150. Each trustee now oversees between 167 and 175 different funds in the Fund  
23 Complex. *See* 2013 SAI 64-65.



1 151. And yet, the Board meets only periodically throughout the year to measure the  
2 proper fee rate for hundreds of different fees the funds in the Fund Complex are charged.

3 **4. The Information Defendants Provide to the PIMCO Board is Inadequate**

4 152. Defendants have also failed to satisfy their fiduciary duty under the Investment  
5 Company Act to provide the Fund’s trustees with all information reasonably necessary for them  
6 to do their jobs, including determining the fairness of the fees. As Morningstar reported, “[t]he  
7 opacity of these data, combined with its girth, suggests that the board has not done all that it can  
8 to aggressively negotiate for better economies of scale or to at least help investors better  
9 understand why the fees they pay are appropriate.” Morningstar Stewardship Report at 5.

10 153. The Board has also failed to provide adequate transparency to shareholders, such  
11 as describing what kinds of expenses are included in the “supervisory and administrative fees.”

12 *See id.*

13 154. Despite a wealth of public information regarding the excessiveness of the fees  
14 charged to the Fund, *see supra* §§ V.A-G, the trustees never negotiated to add breakpoints to  
15 share the benefits of economies of scale experienced by the Defendants, even as the Fund grew  
16 to be the largest fund in the world.

17 155. The trustees’ lack of independence and conscientiousness establishes Defendants’  
18 violation of Section 36 of the ICA, regardless of whether the trustees are presumed  
19 “independent” by Section 10 of the ICA.

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1 VI. CLAIM I

2 ICA § 36(B) BREACH OF FIDUCIARY DUTY  
3 (EXCESSIVE INVESTMENT ADVISORY AND SUPERVISORY/ADMINISTRATIVE  
4 FEES)

5 156. Plaintiff repeats and realleges paragraphs 1 through 155, inclusive, of this  
6 complaint.

7 157. This claim is alleged against Defendant Pacific Investment Management  
8 Company LLC.

9 158. The investment advisory fees charged by the Defendant PIMCO are and continue  
10 to be so disproportionately large that they bear no reasonable relationship to the services  
11 rendered and are not within the range of the compensation that would have been negotiated at  
12 arm's length in light of all the surrounding circumstances (or the range of what has been  
13 negotiated at arm's length). Instead, they are dramatically higher than those negotiated or that  
14 would be negotiated in any arm's-length negotiation.

15 159. Defendant PIMCO has received and continues to receive excessive investment  
16 advisory fees attributable to the extraordinary economies of scale generated through Defendant  
17 PIMCO's provision of investment advisory services to the Fund that have not been shared with  
18 the Plaintiff and the Fund.

19 160. The supervisory and administrative fees charged by Defendant PIMCO are and  
20 continue to be so disproportionately large that they bear no reasonable relationship to the  
21 services rendered and are not within the range of the compensation that would have been  
22 negotiated at arm's length in light of all the surrounding circumstances (or the range of what has  
23 been negotiated at arm's length). Instead, they are dramatically higher than those negotiated or  
24 that would be negotiated in any arm's-length negotiation.

1 161. Defendant PIMCO has received and continues to receive excessive supervisory  
2 and administrative fees attributable to the extraordinary economies of scale generated through  
3 Defendant PIMCO's provision of supervisory and administration services to the Fund that have  
4 not been shared with the Plaintiff and the Fund.

5 162. The supervisory and administrative fees charged by Defendant PIMCO to the  
6 Fund are and have been grossly excessive in light of the true cost of providing those services to  
7 the Fund.

8 163. In charging and receiving excessive investment advisory fees as well as  
9 supervisory and administrative fees and failing to put the interests of the Fund, the Plaintiff, and  
10 the Fund's other shareholders ahead of its own interests, Defendant PIMCO breached its  
11 statutory fiduciary duties to the Fund and the Plaintiff.

12 164. Defendant PIMCO has breached and continues to breach those statutory ICA  
13 Section 36(b) fiduciary duties to the Fund by accepting excessive and inappropriate  
14 compensation. Plaintiff seeks, pursuant to Section 36(b)(3) of the ICA, the "actual damages  
15 resulting from the breach of fiduciary duty" by Defendant PIMCO, up to and including, "the  
16 amount of compensation or payments received from" the Fund, or pursuant to 15 U.S.C. §80-  
17 46(b) ("§47(b) of the ICA"), rescission of the contracts.

18 **VII. CLAIM II**

19 **ICA § 36(B) BREACH OF FIDUCIARY DUTY**  
20 **(EXCESSIVE RULE 12b-1 DISTRIBUTION FEES AND EXTRACTION OF**  
21 **ADDITIONAL COMPENSATION FOR ADVISORY SERVICES)**

22 165. Plaintiff repeats and realleges paragraphs 1 through 164, inclusive, of this  
23 complaint.

24 166. This claim is alleged against Defendant PIMCO Investments LLC.

1           167. The distribution and servicing fees charged and received by Defendant PIMCO  
2 Investments LLC were designed to, and did, extract additional compensation for Defendant  
3 PIMCO Investments LLC’s advisory services in violation of Defendant PIMCO Investments  
4 LLC’s fiduciary duty under Section 36(b).

5           168. Although the distribution and servicing fees may have contributed to the growth  
6 in assets of the Fund, the resulting economies of scale resulting from increased assets under  
7 management in the Fund benefitted only the Defendants, and not Plaintiff or the Fund.

8           169. On information and belief, Defendant PIMCO Investments LLC failed to furnish  
9 information the Board needed to make an informed determination that any Rule 12b-1  
10 distribution plan for which Defendant PIMCO Investments LLC charged distribution and  
11 servicing fees should be continued.

12           170. In failing to pass along economies of scale from the distribution and servicing  
13 fees, and in continuing to assess distribution and servicing fees pursuant to plans of distribution  
14 despite the fact that no benefits inured to Plaintiff, Defendant PIMCO Investments LLC has  
15 violated and continues to violate the ICA and has breached and continues to breach its fiduciary  
16 duty to Plaintiff in violation of Section 36(b), both as a result of a flawed negotiating process  
17 and/or with respect to the substantive amounts of the fees.

18           171. Plaintiff seeks, pursuant to Section 36(b)(3) of the ICA, the “actual damages  
19 resulting from the breach of fiduciary duty” by Defendant PIMCO Investments LLC, up to and  
20 including the “amount of compensation or payments received from” the Fund or, pursuant to  
21 Section 47(b) of the ICA, rescission of the contracts.

1 **VIII. PRAYER FOR RELIEF**

2 WHEREFORE, the Plaintiff demands judgment as follows:

3 a. Declaring that the Defendants violated and continue to violate Section 36(b) of  
4 the ICA and Rule 12b-1 and that any investment advisory and/or supervisory and administrative  
5 and/or distribution agreements entered into between them and the Fund are void *ab initio*;

6 b. Preliminarily and permanently enjoining the Defendants from further violations of  
7 the ICA;

8 c. Awarding damages, including, without limitation, rescissory damages, against the  
9 Defendants in an amount including all investment advisory, supervisory and administrative,  
10 distribution and servicing fees paid to them by Plaintiff and the Fund for all periods not  
11 precluded by any applicable statutes of limitation through the trial of this case, together with  
12 interest, costs, disbursements, attorneys' fees, and such other items as may be allowed to the  
13 maximum extent permitted by law;

14 d. Awarding prospective relief in the form of reduced investment advisory,  
15 supervisory and administrative, distribution and servicing fees in the future based not simply  
16 upon a percentage of assets formula but also based upon the reasonableness of the gross  
17 compensation received by Defendants in absolute dollar terms when considering the assets under  
18 management in the Fund; and

19 e. Such other and further relief as may be proper and just.

20 **JURY DEMAND**

21 172. Plaintiff, on behalf of the PIMCO Total Return Fund, demands a trial by jury on  
22 all claims so triable.

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DATED this 31st day of December, 2014.

KELLER ROHRBACK L.L.P.

By: s/ Michael D. Woerner

By: s/ Tana Lin

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