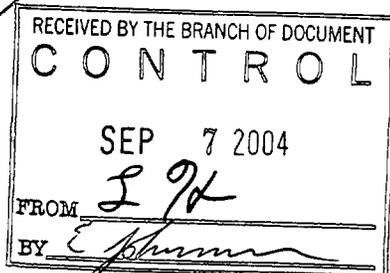
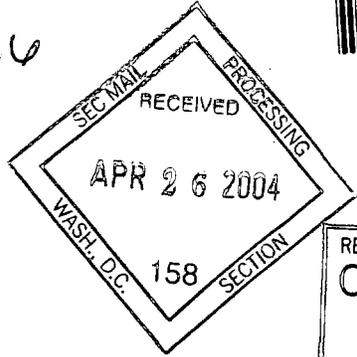


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811-00816



April 23, 2004

VIA FEDERAL EXPRESS

American Century
Investment
Management, Inc.

Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

RE: American Century Investment Management, Inc. ("ACIM")

P.O. Box 418210
4500 Main Street
Kansas City, MO
64141-9210

Ladies and Gentlemen:

Accompanying this letter for filing pursuant to Section 33 of the Investment Company Act of 1940, as amended, is a copy of the Complaint filed in connection with a derivative action brought against ACIM on behalf of certain registered investment companies advised by ACIM.

1-800-345-2021
or
816-531-5575

Should you have any questions or concerns regarding this filing, please contact the undersigned at (816) 340-7276.

www.americancentury.com

Sincerely,

Brian L. Brogan
Vice President and
Assistant General Counsel

BLB:ce

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THOMSON
FINANCIAL

**UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF MISSOURI
CENTRAL DIVISION**

ROBERT L. BAKER, CHARLYNE VAN
OOSBREE, RANDAL C. BREVER,
DONALD HOLCOMB, and LINDA BAILEY,

Plaintiffs,

v.

Case No. 04-4039-CV-C-NKL

AMERICAN CENTURY INVESTMENT
MANAGEMENT, INC. and AMERICAN
CENTURY INVESTMENT SERVICES, INC.,

JURY TRIAL DEMAND

Defendants.

COMPLAINT

Plaintiffs, Ronald L. Baker, Charlyne Van Oosbree, Randal C. Brever, Donald Holcomb, and Linda Bailey, for the use and benefit of the American Century Select Fund, American Century Growth Fund, American Century Ginnie Mae Fund, American Century Giftrust Fund and American Century Ultra Fund, sue Defendants, American Century Investment Management, Inc. and American Century Investment Services, Inc., and allege:

I. JURISDICTION AND VENUE

1. This action is a derivative action brought by Plaintiffs on behalf of the American Century Select Fund, American Century Growth Fund, American Century Giftrust Fund and American Century Ultra Fund (collectively, the "Funds") pursuant to § 36(b) of the Investment Company Act of 1940 ("ICA"), as amended, 15 U.S.C. § 80a-35(b).

2. This Court has subject matter jurisdiction pursuant to 15 U.S.C. § 80a-43, 15 U.S.C.

§ 80a-35(b)(5), and 28 U.S.C. § 1331.

3. Venue is proper in this judicial district pursuant to 15 U.S.C. § 80a-43 and 28 U.S.C. § 1391(b)(2)-(3). Defendants are inhabitants of or transact business in this district, a substantial part of the events or omissions that give rise to Plaintiffs' claims occurred in this district, and Defendants may be found in this district.

4. All conditions precedent have been performed or have occurred.

II. BACKGROUND

5. Plaintiffs are shareholders in various open-end registered investment companies, or mutual funds (collectively the "Funds"), created, sold, advised, and managed with other funds as part of a fund family or complex by Defendants (the "Fund Complex"). Defendants, as the underwriters, distributors, advisors, and control persons of the Funds, owe fiduciary and other duties to Plaintiffs and all shareholders of the funds in the Fund Complex.

6. Plaintiffs and other shareholders of the Funds pay Defendants fees for providing pure investment advisory services and administrative services. These fees are based on a percentage of the net assets of each of the Funds. Defendants typically charge a combined fee for the pure investment advisory services and the administrative services.

7. The pure investment advisory services Defendants provide to the Funds are identical to the investment advisory services Defendants provide to other clients, such as institutional and sub-advisory clients, and entail identical costs. In fact, the cost of advisors, analysts, research data, the physical plant, and other aspects of Defendants' investment advisory services are shared between the mutual funds and the other clients.

8. Despite the equivalence of the investment advisory services Defendants provide

to the Funds and the other clients, the fees Defendants receive from the Funds that are attributable to pure investment advisory services are much higher than the fees Defendants or their affiliates receive from other clients for the identical services.

Section 36(b) of the Investment Company Act of 1940

9. In 1940, Congress enacted the Investment Company Act of 1940, 15 U.S.C. § 80a-1 et seq. (the "ICA"). The ICA was designed to regulate and curb abuses in the mutual fund industry and to create standards of care applicable to investment advisors such as Defendants. In the 1960s, it became clear to Congress that investment advisors to equity mutual funds were gouging those funds with excessive fees, particularly by not taking economies of scale into account. As a result, § 36(b), 15 U.S.C., § 80a-35(b), was added to the ICA in 1970, which created a federal cause of action for breach of fiduciary duty.

10. Section 36(b) provides in pertinent part:

[T]he investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company, or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser. An action may be brought under this subsection by the Commission, or by a security holder of such registered investment company on behalf of such company, against such investment advisers, or an affiliated person of such investment adviser, or any other person enumerated in subsection (a) of this section who has a fiduciary duty concerning such compensation or payments, for breach of fiduciary duty in respect to such compensation or payments paid by such registered investment company or by the security holders thereof to such investment adviser or person. . . .

11. In the past decade, the assets managed by Defendants within the Fund Complex have grown dramatically.

a. In 1993, the Fund Complex (exclusive of money market funds) had average

net assets of approximately \$22 billion and fund shareholders paid \$203 million, or 91 basis points, in advisory fees. Ten years later, by 2002, the Fund Complex (exclusive of money market funds) had significantly grown to nearly \$64 billion in average net assets. In spite of this sizeable increase in assets, advisory fees in 2002 had increased to \$597 million, or 93 basis points. For the Fund Complex as a whole, therefore, advisory fees actually *increased* as a percentage of average net assets from 1993 to 2002.

b. In 1993, the American Century Ultra Fund had \$6 billion in average net assets; by 2002, the fund had grown to \$24.4 billion, a more than four fold increase. Despite this huge increase in assets, advisory fees for the American Century Ultra Fund decreased only slightly as a percentage of average net assets, from 100 basis points in 1993 to 98 basis points in 2002.

12. While the Funds have grown dramatically in size, the nature of the services rendered by Defendants has changed little, if at all. Indeed, advances in computing and communication technologies in the past twenty years have resulted in exponential efficiencies that have dramatically reduced the costs of servicing mutual funds in ways Congress could not have imagined when it enacted ICA § 36(b). Nonetheless, the advisory fees paid to Defendants have grown dramatically. As a result, the advisory fees paid to Defendants (and accepted by them in violation of their statutory fiduciary duties) are disproportionately large in relationship to the services rendered to Plaintiffs.

13. In addition, Defendants, in violation of their fiduciary duties to Plaintiffs, have retained excess profits resulting from economies of scale. These economies of scale are a product of the dramatic growth in assets managed by Defendants. As assets under management increase,

the cost of providing services to additional assets does not increase at the same rate, resulting in tremendous economies of scale. In fact, with very large funds (such as the American Century Ultra Fund), the cost of servicing the additional assets approaches zero. Accordingly, any fees received in connection with the additional assets represent almost pure profit. The excess profits resulting from economies of scale belong to Plaintiffs and the other shareholders of the Funds.

14. The fees paid to Defendants are technically approved by the Funds' board of directors. A majority of the Funds' board[s] [is/are] comprised of statutorily presumed "disinterested" directors as that term is defined in § 10 of the ICA. Regardless of whether these presumably "disinterested" directors meet the requirements of § 10 of the ICA, there is a lack of conscientiousness by the directors in reviewing the advisory and distribution fees paid by each of the Funds. In addition, even if statutorily disinterested, the directors are in all practical respects dominated and unduly influenced by Defendants in reviewing the fees paid by Plaintiffs and other shareholders of the Funds. In particular, Defendants do not provide the directors with sufficient information for the directors to fulfill their obligations, a factor supporting a finding that Defendants have breached their fiduciary duties.

15. Although the fees challenged in this lawsuit may appear to the Court to be very small on a shareholder-by-shareholder basis, they cause a dramatic decrease in Plaintiffs' investment returns over time. Arthur Levitt, past Chairman of the Securities and Exchange Commission ("SEC"), was critical of what he called the "tyranny of compounding high costs":

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

Arthur Levitt, Jr., Inaugural address: Costs Paid with Other People's Money, Address at

Fordham University School of Law (Nov. 3, 2000), in 6 Fordham J. Corp. & Fin. L. 261, 267 (2001).

Nature of Claims

16. In this action, Plaintiff seeks to rescind the investment advisory agreements and to recover the total fees charged by Defendants or, alternatively, to recover the excess profits resulting from economies of scale wrongfully retained by Defendants and to recover other excessive compensation received by, or improper payments wrongfully retained by, Defendants in breach of their fiduciary duty under the ICA § 36(b), 15 U.S.C. § 80a-35(b). Because the conduct complained of herein is continuing in nature, Plaintiffs seek recovery for a period commencing at the earliest date in light of any applicable statute of limitations through the date of final judgment after trial.

17. No pre-suit demand on the board of directors of the Funds is required, as the requirements of F.R.C.P. 23.1 do not apply to actions under § 36(b) of the ICA. *Daily Income Fund v. Fox*, 464 U.S. 523 (1984).

II. PARTIES

18. Plaintiff Ronald L. Baker is a resident of Jefferson City, Missouri. He is a shareholder at all relevant times of the American Century Select Fund.

19. Plaintiff Charlyne Van Oosbree is a resident of Jefferson City, Missouri. She is a shareholder at all relevant times of the American Century Growth Fund, the American Century Select Fund and the American Century Ginnie Mae Fund.

20. Plaintiff Randal C. Brever is a resident of Seffner, Florida. He is a shareholder at all relevant times of the American Century Ultra Fund.

21. Plaintiff Donald Holcomb is a resident of Jefferson City, Missouri. He is the grantor of a trust for the benefit of his grandchildren which at all relevant times owns shares of the American Century Giftrust Fund.

22. Plaintiff Linda Bailey is a resident of Jefferson City, Missouri. She is a shareholder at all relevant times of the American Century Ultra Fund.

23. Defendant American Century Investment Management, Inc. (the "Adviser") is a Delaware corporation and is registered as an investment adviser under the Investment Advisers Act of 1940. The Adviser is the investment adviser to each of the Funds.

24. Defendant American Century Investment Services, Inc. (the "Distributor") is a Delaware corporation and is the distributor of the Funds. The distributor is registered as a broker-dealer under the laws of Missouri and is the distributor and principal underwriter of the Funds.

IV. GENERAL ALLEGATIONS

25. The test for determining whether compensation paid to Defendants violates § 36(b) is "essentially whether the fee schedule represents a charge within the range of what would have been negotiated at arm's-length in the light of all of the surrounding circumstances." *Gartenberg v. Merrill Lynch Asset Management, Inc.*, 694 F.2d 923, 928 (2d Cir. 1982). In order to violate § 36(b), "the advisor-manager must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining." *Id.*

26. In applying this test, all pertinent facts must be weighed in determining whether a fee or other compensation violates § 36(b). The *Gartenberg* court specifically identified six

factors (a portion of “all pertinent facts”) to be considered in determining whether a fee is so disproportionately large that it bears no reasonable relationship to the services rendered. These factors include: (1) the nature and quality of the services rendered; (2) the profitability of the funds to the advisor/manager; (3) economies of scale; (4) comparative fee structures; (5) fallout benefits (i.e. indirect profits to the advisor/manager resulting from the existence of the funds; and (6) the care and conscientiousness of the directors. A review of these factors, and the facts in this case, demonstrates that the fees charged by Defendants to the Funds violate § 36(b).

(1) The Nature and Quality of the Services Provided to the Funds

27. The nature of the investment advisory services provided to the Funds is straightforward: Defendants buy and sell, at their discretion, stocks, bonds, and other securities for the Funds. This is precisely the same service provided to Defendants’ institutional and other clients (albeit at a dramatically lower cost). On information and belief, the materials provided by Defendants to the directors of the Funds establish that the nature of these services has remained unchanged despite dramatic growth in the assets of the Funds and advisory revenues.

28. Despite the fact that the Funds receive identical investment advisory services as Defendants’ sub-advisory, institutional and other clients, on information and belief, Plaintiffs pay Defendants dramatically higher fees because these fees are not negotiated at arm’s length as they are with the other clients. This disparity in fees evinces Defendants’ willingness and determination to prefer their own financial interests to the interests of the Funds and the shareholders of the Funds.

29. On information and belief, Defendants repeatedly put their own financial interests ahead of the interests of the Funds and the shareholders of the Funds by participating in

arrangements and schemes that benefit Defendants at the expense of the Funds and their shareholders. The cost of this conflict of interest, which does not exist in the case of the arm's-length relationships, is manifest not only in higher fees, but in other losses and expenses borne by the Funds and the shareholders of the Funds. These losses and expenses directly impact the quality of the investment advisory services Defendants provide to the Funds

(2) The Profitability of the Fund to the Adviser/Manager

30. “[T]he ‘profitability of the fund to the adviser’ [must] be studied in order that the price paid by the fund to its adviser be equivalent to ‘the product of arm’s-length bargaining.’” See John P. Freeman & Stewart L. Brown, *Mutual Fund Advisory Fees: The Cost of Conflicts of Interest*, 26 J. Corp L. 610, 661 (2001) (the “Freeman & Brown Study”) (citing *Gartenberg*) [Ex. 1]. The profitability of a fund to an adviser-manager is a function of revenues minus the costs of providing services. However, upon information and belief, Defendants' reporting of their revenues and costs is intended to, and does, obfuscate Defendants' true profitability. For instance, upon information and belief, Defendants employ inaccurate accounting practices in their financial reporting, including arbitrary and unreasonable cost allocations.

31. Defendants true profitability can be determined on either an incremental basis or a full-cost basis. Defendants' incremental costs of providing advisory services to Plaintiffs are nominal, while the additional fees received by Defendants are hugely disproportionate given that the nature, quality, and level of the services remain the same. On information and belief, a review of Defendants' full costs of providing advisory services will also demonstrate the enormous profitability to Defendants of managing the Funds.

(3) Economies of Scale

32. The existence of economies of scale in the mutual fund industry has been recently confirmed by both the SEC and the Governmental Accounting Office (the “GAO”). Both conducted in-depth studies of mutual fund fees in 2000, and both concluded that economies of scale exist in the provision of advisory services. *See* SEC Division of Investment Management: Report on Mutual Fund Fees and Expenses (Dec. 2000) (“SEC Report”), at 30-31 [Ex. 2]; GAO, Report on Mutual Fund Fees to the Chairman, Subcommittee on Finance and Hazardous Materials; and the Ranking Member, Committee on Commerce, House of Representatives (June 2000) (“GAO Report”), at 9 [Ex. 3].

33. In addition, the most significant academic research undertaken since the Wharton School study in the 1960s establishes the existence of economies of scale that are not being passed along to mutual fund shareholders in violation of Defendants’ duty to do so under § 36(b) and Rule 12b-1. *See Freeman & Brown Study*” [Ex. 1]. As the Freeman & Brown Study noted: “The existence of economies of scale has been admitted in SEC filings made by fund managers and is implicit in the industry’s frequent use of fee rates that decrease as assets under management increase. Fund industry investment managers are prone to cite economies of scale as justification for business combinations.” *Id.* at 620 [Ex. 1].

34. These economies of scale exist not only fund by fund but also exist with respect to an entire fund complex and even with respect to an investment advisor’s entire scope of operations, including services provided to institutional, sub-advisory and other clients. *See Freeman & Brown Study* at 621 n.62 (quoting Victoria E. Schonfeld & Thomas M.J. Kerwin, *Organization of a Mutual Fund*, 49 *Bus. Law* 107 (1993)) [Ex. 1].

35. The clearest example of economies of scale occurs when total assets under

management increase due purely to market forces (without the institution of new advisory relationships or new asset gathering). In such instances, as the GAO confirms, it is possible for the advisor to service the additional assets with zero additional costs. See GAO Report at 9 (noting that growth from portfolio appreciation is unaccompanied by costs) [Ex. 3]. In other words, an investment advisor can advise a fund that doubles in size purely because of market forces with no increased costs because the services are unchanged. See GAO Report at 9 [Ex. 3]; Freeman & Brown Study at 619 n.43, 621 (noting that investment advisors have benefited by garnering “increased fees from the general increase in market prices with no commensurate efforts on their part” and also noting that as much as 64% of mutual fund asset growth has come from appreciation of portfolio securities, which, unlike growth from share sales to new investors, is costless) [Ex. 1].

36. From 1993 through 2002, Defendants’ assets under management grew from \$22 billion to nearly \$64 billion, an increase of nearly two and a half times. However, this phenomenal growth in mutual fund assets not only produced no economies of scale, but fees for the Fund Complex as a whole actually increased faster than the growth in assets. Fees went from \$203 million in 1993 to \$597 million in 2002. Fees as a percentage of average net assets increased from 91% in 1993 to 93% in 2002. The foregoing figures make a mockery of the concept of economies of scale.

37. Further evidence of Defendants’ refusal to pass along economies of scale to Plaintiffs and other shareholders of the Funds is the advisory fee breakpoint levels for the Funds. For example, the advisory fee structure for the American Century Ultra Fund, Investor Class Shares, is currently 1.00% (100 basis points) of the first \$20 billion in assets, .950% (95 basis

points) of the next \$10 billion, .925% (92.5 basis points) of the next \$10 billion, and .900% (90 basis points) of assets in excess of \$40 billion. The first breakpoint occurs, then, when the fund reaches *\$20 billion* in assets. By way of contrast, when Defendants' act as sub-advisors to mutual funds controlled by third parties, the first breakpoint in their sub-advisory fee typically begins at the \$50 million - \$100 million level. (See paragraph 42, *infra*.)

38. The economies of scale enjoyed by Defendants with respect to the Funds have not been shared with Plaintiffs as required by § 36(b). As a result, the fees paid to Defendants for advisory services provided to the Funds are grossly disproportionate to those services, are excessive, and violate § 36(b).

(4) Comparative Fee Structures

39. The fees advisors receive from mutual funds for investment advisory services are directly comparable to, though much higher than, the fees advisors receive from other clients for the identical services. As the Freeman & Brown Study noted: "None of the leading advisory fee cases involved equity funds, and hence, none of the courts were confronted directly with the strong analogies that can be drawn between equity advisory services in the fund industry as compared to the pension field where prices are notably lower." Freeman & Brown Study at 653 [Ex. 1]. While a "manager may encounter different levels of fixed and variable research costs depending on the type of the portfolio, . . . the fundamental management process is essentially the same for large and small portfolios, as well as for pension funds and mutual funds. The portfolio owner's identity (pension fund versus mutual fund) should not logically provide a reason for portfolio management costs being higher or lower." Freeman & Brown Study at 627-28 [Ex. 1]. Indeed, "a mutual fund, as an entity, actually is an institutional investor. When it comes to fee

discrepancies, the difference between funds and other institutional investors does not turn on 'institutional status,' it turns on self-dealing and conflict of interest." Freeman & Brown Study at 629 n.93 [Ex. 1]. Accordingly, the "'apples-to-apples' fee comparisons between equity pension managers and equity fund managers can be most difficult and embarrassing for those selling advice to mutual funds." Freeman & Brown Study at 671-72 [Ex. 1].

40. More recently, New York's Attorney General surveyed two fund complexes and confirmed the existence of massive over-charging of fund advisory fees. Specifically, Mr. Spitzer testified before a Senate Subcommittee on January 27, 2004, as follows:

Putnam's mutual fund investors were charged 40 percent more for advisory services than Putnam's institutional investors. In dollar terms, what this fee disparity means is that in 2002 Putnam mutual fund investors paid \$290 million more in advisory fees than they would have paid had they been charged the rate given to Putnam's institutional clients, and these are for identical services.

There was a similar disparity in the advisory fees charged by Alliance. Once again, mutual fund investors were charged significantly higher advisory fees than institutional investors. Specifically, Alliance's mutual fund investors paid advisory fees that were twice those paid by institutional investors. In dollar terms, this means that Alliance investors paid more than \$200 million more in advisory fees than they would have paid had they been charged the rate given to Alliance's institutional clients.

41. On information and belief, the shareholders of the Funds at issue here are plagued by the same discriminatory over-charging by Defendants as the shareholders of the funds mentioned by Mr. Spitzer in his Senate testimony. Indeed, a number of relevant comparative fee structures clearly establish that Defendants are charging advisory fees to the Funds that are disproportionate to the value of the services rendered.

42. The Adviser serves as the sub-adviser to the AXP Partners Aggressive Growth Fund, and receives a fee of 50 basis points of the first \$100 million in assets, 45 basis points of the next \$150 million in assets, 40 basis points of the next \$250 million in assets, and 38 basis points of assets in excess of 500 million.

43. The Adviser serves as the sub-adviser to the IDEX American Century International Fund, and receives a fee of 60 basis points of the first \$50 million in assets, 55 basis points of the next \$100 million, 50 basis points of the next \$350 million in assets, and 45 basis points for assets in excess of \$500 million.

44. The Adviser serves as the sub-adviser to the IDEX American Century Income and Growth Fund, and receives a fee of 50 basis points of the first \$100 million in assets, 45 basis points of the next \$150 million, and 40 basis points of assets in excess of \$250 million.

45. An affiliate of the Defendants performs institutional investment advisory services. The fee charged for investment advisory services rendered to the Arizona State Retirement System for managing an active large cap equity account with \$1.1 billion in assets was just 14 basis points in 1999. The fee charged for investment advisory services rendered to the New York State Common Retirement Fund for managing a large cap equity account with \$1.4 billion in assets was just 16.7 basis points in 1999.

(5) Fallout Benefits

46. Defendants indirectly profit because of the existence of the Funds through fallout benefits. Obvious, but difficult to quantify fallout benefits include the attraction of new customers, cross selling related funds to current customers, and other benefits associated generally with the development of goodwill and the growth in assets of the Funds.

47. Other, easier to quantify, benefits include “soft dollars” payable from broker-dealers. Essentially, “soft dollars” are credits furnished to Defendants from broker-dealers and other securities-industry firms in exchange for routing the Funds’ securities transaction orders and other business to paying firms. These soft-dollar credits should be used to purchase research and

other goods or services that benefit the shareholders of the Funds. On information and belief, however, the soft-dollar arrangements benefit Defendants and result in increased costs to the shareholders of the Funds with little to no corresponding benefits to the shareholders of the Funds. On information and belief, the soft dollar arrangements are concealed from the shareholders of the Funds in breach of Defendants' fiduciary duty.

48. On information and belief, Defendants also receive "kickbacks," either directly or indirectly, as transfer agency and custodian fees grow due to increases in the assets of the Funds and the number of shareholders.

49. On information and belief, Defendants receive further fallout benefits from securities lending arrangements. Essentially, Defendants loan out the securities of the Funds and receive compensation as the lending agents of the Funds.

50. A highly profitable fallout benefit to Defendants is the ability to sell investment advisory services paid for by the Funds at virtually no additional cost. Much like computer software, once the investment research and resulting recommendations are paid for, that research and those recommendations may be sold to other clients at virtually no cost whatsoever to Defendants. Without payment by Plaintiffs and other shareholders of the Funds of millions of dollars in advisory and distribution fees (especially distribution fees that are nothing more than a means to extract additional compensation for advisory services), Defendants would have to pay to conduct that research independently in order to provide investment advisory services to other clients, including institutional clients. This is a natural byproduct of the extraordinary economies of scale inherent in the investment advisory business. However, although Plaintiffs and other shareholders of the Funds pay all of the costs associated with the investment advisory services,

Defendants resell these services to third parties without compensating Plaintiffs through reduced fees or in any other way.

51. On information and belief, Defendants do not provide sufficient information regarding the existence and extent of these and other fallout benefits to the shareholders of the Funds or to the Funds' directors. The directors are thus unable to quantify or even meaningfully consider the benefits. Plaintiffs and other shareholders of the Funds have paid for these benefits and are entitled to compensation in the form of reduced advisory fees and the elimination of distribution fees.

(6) The Independence and Conscientiousness of the Directors

52. At least 40% of the Funds' directors must be "disinterested" as defined in § 10 of the ICA. As the GAO Report noted, the structure of most mutual funds embodies a potential conflict of interest between the fund's shareholders and its adviser. This conflict arises because the fees paid by the shareholders represent revenue to the adviser. The United States Supreme Court has stated that the disinterested-director requirement is "the cornerstone of the ICA's efforts to control" this conflict of interest. *Burks v. Lasker*, 441 U.S. 471 (1979).

53. The disinterested directors are supposed to serve as "watchdogs" for the shareholders of the Funds. As such, the disinterested directors have primary responsibility for, among many other things, negotiating and approving all contracts and agreements with Defendants and reviewing the reasonableness of the advisory and distribution fees received by Defendants. Accordingly, as noted by the GAO, the directors are expected to review, among other things, the advisor's costs, whether fees have been reduced when the Funds' assets have

grown, and the fees charged for similar services. See GAO Report at 14 [Ex. 3]. These responsibilities are intensive, requiring the directors to rely on information provided by Defendants. Defendants, in turn, have a fiduciary duty to provide all information reasonably necessary for the directors to perform their obligations. See 15 U.S.C., § 80a-15(c); 17 C.F.R. § 270.12b-1.

54. The ICA contains a presumption that the disinterested directors are in fact disinterested. However, the lack of conscientiousness of even disinterested directors in reviewing the fees paid by the Funds, the lack of adequate information provided to the directors in connection with their approvals of the advisory agreements and Distribution Plans, and the control of management over the directors in reviewing the fees paid by the Funds are not presumed but, rather, are important factors recognized in the *Gartenberg* line of cases in determining whether Defendants have breached their fiduciary duties. In addition, the SEC has specifically recognized that even disinterested directors may not be independent but, rather, may be subject to domination or undue influence by a fund's investment adviser. For example, the SEC has stated that "disinterested directors should not be entrusted with a decision on use of fund assets for distribution without receiving the benefit of measures designed to enhance their ability to act independently." *Bearing of Distribution Expenses by Mutual Funds*, Investment Co. Act Rel. No. 11414, 1980 SEC LEXIS 444 at *36 (Oct. 28, 1980).

55. Two noteworthy industry insiders have commented on the general failure of mutual fund boards to fulfill their responsibilities under the ICA. Jack Bogle, founder of the Vanguard Group, made the following comment:

Well, fund directors are, or at least to a very major extent, sort of a bad joke. They've watched industry fees go up year after year, they've added 12b-1 fees. I think they've forgotten, maybe they've never been told, that the law, the 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.

Warren Buffet, famous investor and chairman of Berkshire Hathaway, Inc. made the following comment, which was recently quoted by a United States District Court:

I think independent directors have been anything but independent. The Investment Company Act, in 1940, made these provisions for independent directors on the theory that they would be the watchdogs for all these people pooling their money. The behavior of independent directors in aggregate since 1940 has been to rubber stamp every deal that's come along from management—whether management was good, bad, or indifferent. Not negotiate for fee reductions and so on. A long time ago, an attorney said that in selecting directors, the management companies were looking for Cocker Spaniels and not Dobermans. I'd say they found a lot of Cocker Spaniels out there. *Strougo v. BEA Assoc.*, 188 F. Supp.2d 373, 383 (S.D.N.Y. 2002) (citation omitted).

Mr. Buffet has also stated, in his letter to shareholders in the 2002 Berkshire Hathaway, Inc. annual report:

[A] monkey will type out a Shakespeare play before an "independent" mutual-fund director will suggest that his fund look at other managers, even if the incumbent manager has persistently delivered substandard performance. When they are handling their own money, of course, directors will look to alternative advisors – but it never enters their minds to do so when they are acting as fiduciaries for others. . . . 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 negotiate materially lower management fees with the incumbent managers of most mutual funds. And, believe me, if directors were promised a portion of any fee savings they realized, the skies would be filled with falling fees. Under the current system, though, reductions mean nothing to "independent" directors while meaning everything to managers. So guess who wins? . . . [I]n stepping up to [their] all-important responsibilities, tens of thousands

of "independent" directors, over more than six decades, have failed miserably. (They've succeeded, however, in taking care of themselves; their fees from serving on multiple boards of a single "family" of funds often run well into six figures.) 2002 Berkshire Hathaway, Inc. Annual Report to Shareholders, p. 17 – 18.

56. As part of their scheme to receive excessive fees, Defendants did not keep the directors fully informed regarding all material facts and aspects of their fees and other compensation, and the directors failed to insist upon adequate information. For example:

c. On information and belief, Defendants provided virtually no information to the directors regarding the advisory fees charged to pension and other institutional clients or to other mutual funds being advised or sub-advised by Defendants.

d. On information and belief, Defendants provided virtually no information to the directors regarding the economies of scale enjoyed or fallout benefits received by Defendants.

e. On information and belief, the profitability data given to the board of directors provide no explanation as to how the board should evaluate economies of scale.

f. On information and belief, the directors rarely, if ever, question any information or recommendations provided by Defendants.

57. The foregoing assures that the directors do not understand Defendants' true cost structure and, in particular, the economies of scale enjoyed by them in providing investment advisory services to the Funds and their institutional and other clients.

58. On information and belief, the disinterested directors of the Funds have not receive the benefit of any measures to enhance their ability to act independently, which has caused the directors to be dependent on Defendants and has allowed Defendants to dominate

and unduly influence the directors. In addition, the directors' failure to insist on adequate information evinces a lack of care and conscientiousness on their part.

COUNT I
ICA §36(b)
BREACH OF FIDUCIARY DUTY
(Excessive Investment Advisory Fees)

59. Plaintiffs repeat and re-allege paragraphs 1 through 58, inclusive, of this complaint.

60. The fees charged by Defendants for providing advisory services to the Funds are and continue to be disproportionate to the services rendered and are not within the range of what would have been negotiated at arm's length in light of all the surrounding circumstances, including the advisory fees that Defendants charge their other clients.

61. In charging and receiving excessive or inappropriate compensation, and in failing to put the interests of Plaintiffs and the other shareholders of the Funds ahead of their own interests, Defendants have breached and continue to breach their statutory fiduciary duty to Plaintiffs in violation of ICA § 36(b).

62. Plaintiffs seek, pursuant to § 36(b)(3) of the ICA, the "actual damages resulting from the breach of fiduciary duty" by Defendants, up to and including, "the amount of compensation or payments received from" the Funds.

COUNT II
ICA § 36(b)
BREACH OF FIDUCIARY DUTY
(Excess Profits from Economies of Scale)

63. Plaintiffs repeat and re-allege paragraphs 1 through 58, inclusive, of this complaint.

64. Defendants have received and continue to receive excess profits attributable to extraordinary economies of scale.

65. By retaining excess profits derived from economies of scale, Defendants have breached and continue to breach their statutory fiduciary duty to Plaintiffs in violation of ICA § 36(b).

66. Plaintiffs seek, pursuant to § 36(b)(3) of the ICA, the “actual damages resulting from the breach of fiduciary duty” by Defendants, up to and including, the “amount of compensation or payments received from” the Funds.

WHEREFORE, Plaintiffs demand judgment as follows:

- a. An order declaring that Defendants have violated and continue to violate § 36(b) of the ICA and that any advisory agreements entered into are void ab initio;
- b. An order preliminarily and permanently enjoining Defendants from further violations of the ICA;
- c. An order awarding damages against Defendants including all fees paid to them by Plaintiffs and the Funds for all periods not precluded by any applicable statutes of limitation through the trial of this case, together with interest, costs, disbursements, attorneys’ fees, and such other items as may be allowed to the maximum extent permitted by law; and
- d. Such other and further relief as may be proper and just.

By: s/ Wm. Dirk Vandever

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DEMAND FOR JURY TRIAL

Plaintiffs hereby demand a jury trial on all issues.

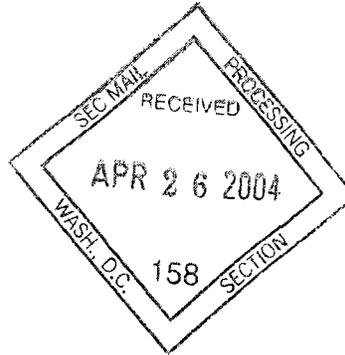
s/ Wm. Dirk Vandever
Attorneys for Plaintiff

40-33



AMERICAN CENTURY®

April 23, 2004



VIA FEDERAL EXPRESS

American Century
Investment
Management, Inc.

Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

RE: American Century Investment Management, Inc. ("ACIM")

P.O. Box 418210
4500 Main Street
Kansas City, MO
64141-9210

Ladies and Gentlemen:

1-800-345-2021
or
816-531-5575

Accompanying this letter for filing pursuant to Section 33 of the Investment Company Act of 1940, as amended, is a copy of the Complaint filed in connection with a derivative action brought against ACIM on behalf of certain registered investment companies advised by ACIM.

Should you have any questions or concerns regarding this filing, please contact the undersigned at (816) 340-7276.

www.americancentury.com

Sincerely,

Brian L. Brogan
Vice President and
Assistant General Counsel

BLB:ce

**UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF MISSOURI
CENTRAL DIVISION**

ROBERT L. BAKER, CHARLYNE VAN
OOSBREE, RANDAL C. BREVER,
DONALD HOLCOMB, and LINDA BAILEY,

Plaintiffs,

v.

Case No. 04-4039-CV-C-NKL

AMERICAN CENTURY INVESTMENT
MANAGEMENT, INC. and AMERICAN
CENTURY INVESTMENT SERVICES, INC.,

JURY TRIAL DEMAND

Defendants.

COMPLAINT

Plaintiffs, Ronald L. Baker, Charlyne Van Oosbree, Randal C. Brever, Donald Holcomb, and Linda Bailey, for the use and benefit of the American Century Select Fund, American Century Growth Fund, American Century Ginnie Mae Fund, American Century Giftrust Fund and American Century Ultra Fund, sue Defendants, American Century Investment Management, Inc. and American Century Investment Services, Inc., and allege:

I. JURISDICTION AND VENUE

1. This action is a derivative action brought by Plaintiffs on behalf of the American Century Select Fund, American Century Growth Fund, American Century Giftrust Fund and American Century Ultra Fund (collectively, the "Funds") pursuant to § 36(b) of the Investment Company Act of 1940 ("ICA"), as amended, 15 U.S.C. § 80a-35(b).

2. This Court has subject matter jurisdiction pursuant to 15 U.S.C. § 80a-43, 15 U.S.C.

§ 80a-35(b)(5), and 28 U.S.C. § 1331.

3. Venue is proper in this judicial district pursuant to 15 U.S.C. § 80a-43 and 28 U.S.C. § 1391(b)(2)-(3). Defendants are inhabitants of or transact business in this district, a substantial part of the events or omissions that give rise to Plaintiffs' claims occurred in this district, and Defendants may be found in this district.

4. All conditions precedent have been performed or have occurred.

II. BACKGROUND

5. Plaintiffs are shareholders in various open-end registered investment companies, or mutual funds (collectively the "Funds"), created, sold, advised, and managed with other funds as part of a fund family or complex by Defendants (the "Fund Complex"). Defendants, as the underwriters, distributors, advisors, and control persons of the Funds, owe fiduciary and other duties to Plaintiffs and all shareholders of the funds in the Fund Complex.

6. Plaintiffs and other shareholders of the Funds pay Defendants fees for providing pure investment advisory services and administrative services. These fees are based on a percentage of the net assets of each of the Funds. Defendants typically charge a combined fee for the pure investment advisory services and the administrative services.

7. The pure investment advisory services Defendants provide to the Funds are identical to the investment advisory services Defendants provide to other clients, such as institutional and sub-advisory clients, and entail identical costs. In fact, the cost of advisors, analysts, research data, the physical plant, and other aspects of Defendants' investment advisory services are shared between the mutual funds and the other clients.

8. Despite the equivalence of the investment advisory services Defendants provide

to the Funds and the other clients, the fees Defendants receive from the Funds that are attributable to pure investment advisory services are much higher than the fees Defendants or their affiliates receive from other clients for the identical services.

Section 36(b) of the Investment Company Act of 1940

9. In 1940, Congress enacted the Investment Company Act of 1940, 15 U.S.C. § 80a-1 et seq. (the "ICA"). The ICA was designed to regulate and curb abuses in the mutual fund industry and to create standards of care applicable to investment advisors such as Defendants. In the 1960s, it became clear to Congress that investment advisors to equity mutual funds were gouging those funds with excessive fees, particularly by not taking economies of scale into account. As a result, § 36(b), 15 U.S.C., § 80a-35(b), was added to the ICA in 1970, which created a federal cause of action for breach of fiduciary duty.

10. Section 36(b) provides in pertinent part:

[T]he investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company, or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser. An action may be brought under this subsection by the Commission, or by a security holder of such registered investment company on behalf of such company, against such investment advisers, or an affiliated person of such investment advisor, or any other person enumerated in subsection (a) of this section who has a fiduciary duty concerning such compensation or payments, for breach of fiduciary duty in respect to such compensation or payments paid by such registered investment company or by the security holders thereof to such investment adviser or person. . . .

11. In the past decade, the assets managed by Defendants within the Fund Complex have grown dramatically.

a. In 1993, the Fund Complex (exclusive of money market funds) had average

net assets of approximately \$22 billion and fund shareholders paid \$203 million, or 91 basis points, in advisory fees. Ten years later, by 2002, the Fund Complex (exclusive of money market funds) had significantly grown to nearly \$64 billion in average net assets. In spite of this sizeable increase in assets, advisory fees in 2002 had increased to \$597 million, or 93 basis points. For the Fund Complex as a whole, therefore, advisory fees actually *increased* as a percentage of average net assets from 1993 to 2002.

b. In 1993, the American Century Ultra Fund had \$6 billion in average net assets; by 2002, the fund had grown to \$24.4 billion, a more than four fold increase. Despite this huge increase in assets, advisory fees for the American Century Ultra Fund decreased only slightly as a percentage of average net assets, from 100 basis points in 1993 to 98 basis points in 2002.

12. While the Funds have grown dramatically in size, the nature of the services rendered by Defendants has changed little, if at all. Indeed, advances in computing and communication technologies in the past twenty years have resulted in exponential efficiencies that have dramatically reduced the costs of servicing mutual funds in ways Congress could not have imagined when it enacted ICA § 36(b). Nonetheless, the advisory fees paid to Defendants have grown dramatically. As a result, the advisory fees paid to Defendants (and accepted by them in violation of their statutory fiduciary duties) are disproportionately large in relationship to the services rendered to Plaintiffs.

13. In addition, Defendants, in violation of their fiduciary duties to Plaintiffs, have retained excess profits resulting from economies of scale. These economies of scale are a product of the dramatic growth in assets managed by Defendants. As assets under management increase,

the cost of providing services to additional assets does not increase at the same rate, resulting in tremendous economies of scale. In fact, with very large funds (such as the American Century Ultra Fund), the cost of servicing the additional assets approaches zero. Accordingly, any fees received in connection with the additional assets represent almost pure profit. The excess profits resulting from economies of scale belong to Plaintiffs and the other shareholders of the Funds.

14. The fees paid to Defendants are technically approved by the Funds' board of directors. A majority of the Funds' board[s] [is/are] comprised of statutorily presumed "disinterested" directors as that term is defined in § 10 of the ICA. Regardless of whether these presumably "disinterested" directors meet the requirements of § 10 of the ICA, there is a lack of conscientiousness by the directors in reviewing the advisory and distribution fees paid by each of the Funds. In addition, even if statutorily disinterested, the directors are in all practical respects dominated and unduly influenced by Defendants in reviewing the fees paid by Plaintiffs and other shareholders of the Funds. In particular, Defendants do not provide the directors with sufficient information for the directors to fulfill their obligations, a factor supporting a finding that Defendants have breached their fiduciary duties.

15. Although the fees challenged in this lawsuit may appear to the Court to be very small on a shareholder-by-shareholder basis, they cause a dramatic decrease in Plaintiffs' investment returns over time. Arthur Levitt, past Chairman of the Securities and Exchange Commission ("SEC"), was critical of what he called the "tyranny of compounding high costs":

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

Arthur Levitt, Jr., Inaugural address: Costs Paid with Other People's Money, Address at

Fordham University School of Law (Nov. 3, 2000), in 6 Fordham J. Corp. & Fin. L. 261, 267 (2001).

Nature of Claims

16. In this action, Plaintiff seeks to rescind the investment advisory agreements and to recover the total fees charged by Defendants or, alternatively, to recover the excess profits resulting from economies of scale wrongfully retained by Defendants and to recover other excessive compensation received by, or improper payments wrongfully retained by, Defendants in breach of their fiduciary duty under the ICA § 36(b), 15 U.S.C. § 80a-35(b). Because the conduct complained of herein is continuing in nature, Plaintiffs seek recovery for a period commencing at the earliest date in light of any applicable statute of limitations through the date of final judgment after trial.

17. No pre-suit demand on the board of directors of the Funds is required, as the requirements of F.R.C.P. 23.1 do not apply to actions under § 36(b) of the ICA. *Daily Income Fund v. Fox*, 464 U.S. 523 (1984).

II. PARTIES

18. Plaintiff Ronald L. Baker is a resident of Jefferson City, Missouri. He is a shareholder at all relevant times of the American Century Select Fund.

19. Plaintiff Charlyne Van Oosbree is a resident of Jefferson City, Missouri. She is a shareholder at all relevant times of the American Century Growth Fund, the American Century Select Fund and the American Century Ginnie Mae Fund.

20. Plaintiff Randal C. Brevier is a resident of Seffner, Florida. He is a shareholder at all relevant times of the American Century Ultra Fund.

21. Plaintiff Donald Holcomb is a resident of Jefferson City, Missouri. He is the grantor of a trust for the benefit of his grandchildren which at all relevant times owns shares of the American Century Giftrust Fund.

22. Plaintiff Linda Bailey is a resident of Jefferson City, Missouri. She is a shareholder at all relevant times of the American Century Ultra Fund.

23. Defendant American Century Investment Management, Inc. (the "Adviser") is a Delaware corporation and is registered as an investment adviser under the Investment Advisers Act of 1940. The Adviser is the investment adviser to each of the Funds.

24. Defendant American Century Investment Services, Inc. (the "Distributor") is a Delaware corporation and is the distributor of the Funds. The distributor is registered as a broker-dealer under the laws of Missouri and is the distributor and principal underwriter of the Funds.

IV. GENERAL ALLEGATIONS

25. The test for determining whether compensation paid to Defendants violates § 36(b) is "essentially whether the fee schedule represents a charge within the range of what would have been negotiated at arm's-length in the light of all of the surrounding circumstances." *Gartenberg v. Merrill Lynch Asset Management, Inc.*, 694 F.2d 923, 928 (2d Cir. 1982). In order to violate § 36(b), "the advisor-manager must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining." *Id.*

26. In applying this test, all pertinent facts must be weighed in determining whether a fee or other compensation violates § 36(b). The *Gartenberg* court specifically identified six

factors (a portion of “all pertinent facts”) to be considered in determining whether a fee is so disproportionately large that it bears no reasonable relationship to the services rendered. These factors include: (1) the nature and quality of the services rendered; (2) the profitability of the funds to the advisor/manager; (3) economies of scale; (4) comparative fee structures; (5) fallout benefits (i.e. indirect profits to the advisor/manager resulting from the existence of the funds; and (6) the care and conscientiousness of the directors. A review of these factors, and the facts in this case, demonstrates that the fees charged by Defendants to the Funds violate § 36(b).

(1) The Nature and Quality of the Services Provided to the Funds

27. The nature of the investment advisory services provided to the Funds is straightforward: Defendants buy and sell, at their discretion, stocks, bonds, and other securities for the Funds. This is precisely the same service provided to Defendants’ institutional and other clients (albeit at a dramatically lower cost). On information and belief, the materials provided by Defendants to the directors of the Funds establish that the nature of these services has remained unchanged despite dramatic growth in the assets of the Funds and advisory revenues.

28. Despite the fact that the Funds receive identical investment advisory services as Defendants’ sub-advisory, institutional and other clients, on information and belief, Plaintiffs pay Defendants dramatically higher fees because these fees are not negotiated at arm’s length as they are with the other clients. This disparity in fees evinces Defendants’ willingness and determination to prefer their own financial interests to the interests of the Funds and the shareholders of the Funds.

29. On information and belief, Defendants repeatedly put their own financial interests ahead of the interests of the Funds and the shareholders of the Funds by participating in

arrangements and schemes that benefit Defendants at the expense of the Funds and their shareholders. The cost of this conflict of interest, which does not exist in the case of the arm's-length relationships, is manifest not only in higher fees, but in other losses and expenses borne by the Funds and the shareholders of the Funds. These losses and expenses directly impact the quality of the investment advisory services Defendants provide to the Funds

(2) The Profitability of the Fund to the Adviser/Manager

30. “[T]he ‘profitability of the fund to the adviser’ [must] be studied in order that the price paid by the fund to its adviser be equivalent to ‘the product of arm’s-length bargaining.’” See John P. Freeman & Stewart L. Brown, *Mutual Fund Advisory Fees: The Cost of Conflicts of Interest*, 26 J. Corp L. 610, 661 (2001) (the “Freeman & Brown Study”) (citing *Gartenberg*) [Ex. 1]. The profitability of a fund to an adviser-manager is a function of revenues minus the costs of providing services. However, upon information and belief, Defendants' reporting of their revenues and costs is intended to, and does, obfuscate Defendants' true profitability. For instance, upon information and belief, Defendants employ inaccurate accounting practices in their financial reporting, including arbitrary and unreasonable cost allocations.

31. Defendants true profitability can be determined on either an incremental basis or a full-cost basis. Defendants' incremental costs of providing advisory services to Plaintiffs are nominal, while the additional fees received by Defendants are hugely disproportionate given that the nature, quality, and level of the services remain the same. On information and belief, a review of Defendants' full costs of providing advisory services will also demonstrate the enormous profitability to Defendants of managing the Funds.

(3) Economies of Scale

32. The existence of economies of scale in the mutual fund industry has been recently confirmed by both the SEC and the Governmental Accounting Office (the "GAO"). Both conducted in-depth studies of mutual fund fees in 2000, and both concluded that economies of scale exist in the provision of advisory services. *See* SEC Division of Investment Management: Report on Mutual Fund Fees and Expenses (Dec. 2000) ("SEC Report"), at 30-31 [Ex. 2]; GAO, Report on Mutual Fund Fees to the Chairman, Subcommittee on Finance and Hazardous Materials; and the Ranking Member, Committee on Commerce, House of Representatives (June 2000) ("GAO Report"), at 9 [Ex. 3].

33. In addition, the most significant academic research undertaken since the Wharton School study in the 1960s establishes the existence of economies of scale that are not being passed along to mutual fund shareholders in violation of Defendants' duty to do so under § 36(b) and Rule 12b-1. *See* Freeman & Brown Study" [Ex. 1]. As the Freeman & Brown Study noted: "The existence of economies of scale has been admitted in SEC filings made by fund managers and is implicit in the industry's frequent use of fee rates that decrease as assets under management increase. Fund industry investment managers are prone to cite economies of scale as justification for business combinations." *Id.* at 620 [Ex. 1].

34. These economies of scale exist not only fund by fund but also exist with respect to an entire fund complex and even with respect to an investment advisor's entire scope of operations, including services provided to institutional, sub-advisory and other clients. *See* Freeman & Brown Study at 621 n.62 (quoting Victoria E. Schonfeld & Thomas M.J. Kerwin, Organization of a Mutual Fund, 49 Bus. Law 107 (1993)) [Ex. 1].

35. The clearest example of economies of scale occurs when total assets under

management increase due purely to market forces (without the institution of new advisory relationships or new asset gathering). In such instances, as the GAO confirms, it is possible for the advisor to service the additional assets with zero additional costs. See GAO Report at 9 (noting that growth from portfolio appreciation is unaccompanied by costs) [Ex. 3]. In other words, an investment advisor can advise a fund that doubles in size purely because of market forces with no increased costs because the services are unchanged. See GAO Report at 9 [Ex. 3]; Freeman & Brown Study at 619 n.43, 621 (noting that investment advisors have benefited by garnering “increased fees from the general increase in market prices with no commensurate efforts on their part” and also noting that as much as 64% of mutual fund asset growth has come from appreciation of portfolio securities, which, unlike growth from share sales to new investors, is costless) [Ex. 1].

36. From 1993 through 2002, Defendants’ assets under management grew from \$22 billion to nearly \$64 billion, an increase of nearly two and a half times. However, this phenomenal growth in mutual fund assets not only produced no economies of scale, but fees for the Fund Complex as a whole actually increased faster than the growth in assets. Fees went from \$203 million in 1993 to \$597 million in 2002. Fees as a percentage of average net assets increased from 91% in 1993 to 93% in 2002. The foregoing figures make a mockery of the concept of economies of scale.

37. Further evidence of Defendants’ refusal to pass along economies of scale to Plaintiffs and other shareholders of the Funds is the advisory fee breakpoint levels for the Funds. For example, the advisory fee structure for the American Century Ultra Fund, Investor Class Shares, is currently 1.00% (100 basis points) of the first \$20 billion in assets, .950% (95 basis

points) of the next \$10 billion, .925% (92.5 basis points) of the next \$10 billion, and .900% (90 basis points) of assets in excess of \$40 billion. The first breakpoint occurs, then, when the fund reaches **\$20 billion** in assets. By way of contrast, when Defendants' act as sub-advisors to mutual funds controlled by third parties, the first breakpoint in their sub-advisory fee typically begins at the \$50 million - \$100 million level. (See paragraph 42, *infra*.)

38. The economies of scale enjoyed by Defendants with respect to the Funds have not been shared with Plaintiffs as required by § 36(b). As a result, the fees paid to Defendants for advisory services provided to the Funds are grossly disproportionate to those services, are excessive, and violate § 36(b).

(4) Comparative Fee Structures

39. The fees advisors receive from mutual funds for investment advisory services are directly comparable to, though much higher than, the fees advisors receive from other clients for the identical services. As the Freeman & Brown Study noted: "None of the leading advisory fee cases involved equity funds, and hence, none of the courts were confronted directly with the strong analogies that can be drawn between equity advisory services in the fund industry as compared to the pension field where prices are notably lower." Freeman & Brown Study at 653 [Ex. 1]. While a "manager may encounter different levels of fixed and variable research costs depending on the type of the portfolio, . . . the fundamental management process is essentially the same for large and small portfolios, as well as for pension funds and mutual funds. The portfolio owner's identity (pension fund versus mutual fund) should not logically provide a reason for portfolio management costs being higher or lower." Freeman & Brown Study at 627-28 [Ex. 1]. Indeed, "a mutual fund, as an entity, actually is an institutional investor. When it comes to fee

discrepancies, the difference between funds and other institutional investors does not turn on 'institutional status,' it turns on self-dealing and conflict of interest." Freeman & Brown Study at 629 n.93 [Ex. 1]. Accordingly, the "'apples-to-apples' fee comparisons between equity pension managers and equity fund managers can be most difficult and embarrassing for those selling advice to mutual funds." Freeman & Brown Study at 671-72 [Ex. 1].

40. More recently, New York's Attorney General surveyed two fund complexes and confirmed the existence of massive over-charging of fund advisory fees. Specifically, Mr. Spitzer testified before a Senate Subcommittee on January 27, 2004, as follows:

Putnam's mutual fund investors were charged 40 percent more for advisory services than Putnam's institutional investors. In dollar terms, what this fee disparity means is that in 2002 Putnam mutual fund investors paid \$290 million more in advisory fees than they would have paid had they been charged the rate given to Putnam's institutional clients, and these are for identical services.

There was a similar disparity in the advisory fees charged by Alliance. Once again, mutual fund investors were charged significantly higher advisory fees than institutional investors. Specifically, Alliance's mutual fund investors paid advisory fees that were twice those paid by institutional investors. In dollar terms, this means that Alliance investors paid more than \$200 million more in advisory fees than they would have paid had they been charged the rate given to Alliance's institutional clients.

41. On information and belief, the shareholders of the Funds at issue here are plagued by the same discriminatory over-charging by Defendants as the shareholders of the funds mentioned by Mr. Spitzer in his Senate testimony. Indeed, a number of relevant comparative fee structures clearly establish that Defendants are charging advisory fees to the Funds that are disproportionate to the value of the services rendered.

42. The Adviser serves as the sub-adviser to the AXP Partners Aggressive Growth Fund, and receives a fee of 50 basis points of the first \$100 million in assets, 45 basis points of the next \$150 million in assets, 40 basis points of the next \$250 million in assets, and 38 basis points of assets in excess of 500 million.

43. The Adviser serves as the sub-adviser to the IDEX American Century International Fund, and receives a fee of 60 basis points of the first \$50 million in assets, 55 basis points of the next \$100 million, 50 basis points of the next \$350 million in assets, and 45 basis points for assets in excess of \$500 million.

44. The Adviser serves as the sub-adviser to the IDEX American Century Income and Growth Fund, and receives a fee of 50 basis points of the first \$100 million in assets, 45 basis points of the next \$150 million, and 40 basis points of assets in excess of \$250 million.

45. An affiliate of the Defendants performs institutional investment advisory services. The fee charged for investment advisory services rendered to the Arizona State Retirement System for managing an active large cap equity account with \$1.1 billion in assets was just 14 basis points in 1999. The fee charged for investment advisory services rendered to the New York State Common Retirement Fund for managing a large cap equity account with \$1.4 billion in assets was just 16.7 basis points in 1999.

(5) Fallout Benefits

46. Defendants indirectly profit because of the existence of the Funds through fallout benefits. Obvious, but difficult to quantify fallout benefits include the attraction of new customers, cross selling related funds to current customers, and other benefits associated generally with the development of goodwill and the growth in assets of the Funds.

47. Other, easier to quantify, benefits include "soft dollars" payable from broker-dealers. Essentially, "soft dollars" are credits furnished to Defendants from broker-dealers and other securities-industry firms in exchange for routing the Funds' securities transaction orders and other business to paying firms. These soft-dollar credits should be used to purchase research and

other goods or services that benefit the shareholders of the Funds. On information and belief, however, the soft-dollar arrangements benefit Defendants and result in increased costs to the shareholders of the Funds with little to no corresponding benefits to the shareholders of the Funds. On information and belief, the soft dollar arrangements are concealed from the shareholders of the Funds in breach of Defendants' fiduciary duty.

48. On information and belief, Defendants also receive "kickbacks," either directly or indirectly, as transfer agency and custodian fees grow due to increases in the assets of the Funds and the number of shareholders.

49. On information and belief, Defendants receive further fallout benefits from securities lending arrangements. Essentially, Defendants loan out the securities of the Funds and receive compensation as the lending agents of the Funds.

50. A highly profitable fallout benefit to Defendants is the ability to sell investment advisory services paid for by the Funds at virtually no additional cost. Much like computer software, once the investment research and resulting recommendations are paid for, that research and those recommendations may be sold to other clients at virtually no cost whatsoever to Defendants. Without payment by Plaintiffs and other shareholders of the Funds of millions of dollars in advisory and distribution fees (especially distribution fees that are nothing more than a means to extract additional compensation for advisory services), Defendants would have to pay to conduct that research independently in order to provide investment advisory services to other clients, including institutional clients. This is a natural byproduct of the extraordinary economies of scale inherent in the investment advisory business. However, although Plaintiffs and other shareholders of the Funds pay all of the costs associated with the investment advisory services,

Defendants resell these services to third parties without compensating Plaintiffs through reduced fees or in any other way.

51. On information and belief, Defendants do not provide sufficient information regarding the existence and extent of these and other fallout benefits to the shareholders of the Funds or to the Funds' directors. The directors are thus unable to quantify or even meaningfully consider the benefits. Plaintiffs and other shareholders of the Funds have paid for these benefits and are entitled to compensation in the form of reduced advisory fees and the elimination of distribution fees.

(6) The Independence and Conscientiousness of the Directors

52. At least 40% of the Funds' directors must be "disinterested" as defined in § 10 of the ICA. As the GAO Report noted, the structure of most mutual funds embodies a potential conflict of interest between the fund's shareholders and its adviser. This conflict arises because the fees paid by the shareholders represent revenue to the adviser. The United States Supreme Court has stated that the disinterested-director requirement is "the cornerstone of the ICA's efforts to control" this conflict of interest. *Burks v. Lasker*, 441 U.S. 471 (1979).

53. The disinterested directors are supposed to serve as "watchdogs" for the shareholders of the Funds. As such, the disinterested directors have primary responsibility for, among many other things, negotiating and approving all contracts and agreements with Defendants and reviewing the reasonableness of the advisory and distribution fees received by Defendants. Accordingly, as noted by the GAO, the directors are expected to review, among other things, the advisor's costs, whether fees have been reduced when the Funds' assets have

grown, and the fees charged for similar services. See GAO Report at 14 [Ex. 3]. These responsibilities are intensive, requiring the directors to rely on information provided by Defendants. Defendants, in turn, have a fiduciary duty to provide all information reasonably necessary for the directors to perform their obligations. See 15 U.S.C., § 80a-15(c); 17 C.F.R. § 270.12b-1.

54. The ICA contains a presumption that the disinterested directors are in fact disinterested. However, the lack of conscientiousness of even disinterested directors in reviewing the fees paid by the Funds, the lack of adequate information provided to the directors in connection with their approvals of the advisory agreements and Distribution Plans, and the control of management over the directors in reviewing the fees paid by the Funds are not presumed but, rather, are important factors recognized in the *Gartenberg* line of cases in determining whether Defendants have breached their fiduciary duties. In addition, the SEC has specifically recognized that even disinterested directors may not be independent but, rather, may be subject to domination or undue influence by a fund's investment adviser. For example, the SEC has stated that "disinterested directors should not be entrusted with a decision on use of fund assets for distribution without receiving the benefit of measures designed to enhance their ability to act independently." *Bearing of Distribution Expenses by Mutual Funds*, Investment Co. Act Rel. No. 11414, 1980 SEC LEXIS 444 at *36 (Oct. 28, 1980).

55. Two noteworthy industry insiders have commented on the general failure of mutual fund boards to fulfill their responsibilities under the ICA. Jack Bogle, founder of the Vanguard Group, made the following comment:

Well, fund directors are, or at least to a very major extent, sort of a bad joke. They've watched industry fees go up year after year, they've added 12b-1 fees. I think they've forgotten, maybe they've never been told, that the law, the 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.

Warren Buffet, famous investor and chairman of Berkshire Hathaway, Inc. made the following comment, which was recently quoted by a United States District Court:

I think independent directors have been anything but independent. The Investment Company Act, in 1940, made these provisions for independent directors on the theory that they would be the watchdogs for all these people pooling their money. The behavior of independent directors in aggregate since 1940 has been to rubber stamp every deal that's come along from management—whether management was good, bad, or indifferent. Not negotiate for fee reductions and so on. A long time ago, an attorney said that in selecting directors, the management companies were looking for Cocker Spaniels and not Dobermans. I'd say they found a lot of Cocker Spaniels out there. *Strougo v. BEA Assoc.*, 188 F. Supp.2d 373, 383 (S.D.N.Y. 2002) (citation omitted).

Mr. Buffet has also stated, in his letter to shareholders in the 2002 Berkshire Hathaway, Inc. annual report:

[A] monkey will type out a Shakespeare play before an "independent" mutual-fund director will suggest that his fund look at other managers, even if the incumbent manager has persistently delivered substandard performance. When they are handling their own money, of course, directors will look to alternative advisors – but it never enters their minds to do so when they are acting as fiduciaries for others. . . . 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 negotiate materially lower management fees with the incumbent managers of most mutual funds. And, believe me, if directors were promised a portion of any fee savings they realized, the skies would be filled with falling fees. Under the current system, though, reductions mean nothing to "independent" directors while meaning everything to managers. So guess who wins? . . . [I]n stepping up to [their] all-important responsibilities, tens of thousands

of "independent" directors, over more than six decades, have failed miserably. (They've succeeded, however, in taking care of themselves; their fees from serving on multiple boards of a single "family" of funds often run well into six figures.) 2002 Berkshire Hathaway, Inc. Annual Report to Shareholders, p. 17 – 18.

56. As part of their scheme to receive excessive fees, Defendants did not keep the directors fully informed regarding all material facts and aspects of their fees and other compensation, and the directors failed to insist upon adequate information. For example:

c. On information and belief, Defendants provided virtually no information to the directors regarding the advisory fees charged to pension and other institutional clients or to other mutual funds being advised or sub-advised by Defendants.

d. On information and belief, Defendants provided virtually no information to the directors regarding the economies of scale enjoyed or fallout benefits received by Defendants.

e. On information and belief, the profitability data given to the board of directors provide no explanation as to how the board should evaluate economies of scale.

f. On information and belief, the directors rarely, if ever, question any information or recommendations provided by Defendants.

57. The foregoing assures that the directors do not understand Defendants' true cost structure and, in particular, the economies of scale enjoyed by them in providing investment advisory services to the Funds and their institutional and other clients.

58. On information and belief, the disinterested directors of the Funds have not receive the benefit of any measures to enhance their ability to act independently, which has caused the directors to be dependent on Defendants and has allowed Defendants to dominate

and unduly influence the directors. In addition, the directors' failure to insist on adequate information evinces a lack of care and conscientiousness on their part.

COUNT I
ICA §36(b)
BREACH OF FIDUCIARY DUTY
(Excessive Investment Advisory Fees)

59. Plaintiffs repeat and re-allege paragraphs 1 through 58, inclusive, of this complaint.

60. The fees charged by Defendants for providing advisory services to the Funds are and continue to be disproportionate to the services rendered and are not within the range of what would have been negotiated at arm's length in light of all the surrounding circumstances, including the advisory fees that Defendants charge their other clients.

61. In charging and receiving excessive or inappropriate compensation, and in failing to put the interests of Plaintiffs and the other shareholders of the Funds ahead of their own interests, Defendants have breached and continue to breach their statutory fiduciary duty to Plaintiffs in violation of ICA § 36(b).

62. Plaintiffs seek, pursuant to § 36(b)(3) of the ICA, the "actual damages resulting from the breach of fiduciary duty" by Defendants, up to and including, "the amount of compensation or payments received from" the Funds.

COUNT II
ICA § 36(b)
BREACH OF FIDUCIARY DUTY
(Excess Profits from Economies of Scale)

63. Plaintiffs repeat and re-allege paragraphs 1 through 58, inclusive, of this complaint.

64. Defendants have received and continue to receive excess profits attributable to extraordinary economies of scale.

65. By retaining excess profits derived from economies of scale, Defendants have breached and continue to breach their statutory fiduciary duty to Plaintiffs in violation of ICA § 36(b).

66. Plaintiffs seek, pursuant to § 36(b)(3) of the ICA, the “actual damages resulting from the breach of fiduciary duty” by Defendants, up to and including, the “amount of compensation or payments received from” the Funds.

WHEREFORE, Plaintiffs demand judgment as follows:

a. An order declaring that Defendants have violated and continue to violate § 36(b) of the ICA and that any advisory agreements entered into are void ab initio;

b. An order preliminarily and permanently enjoining Defendants from further violations of the ICA;

c. An order awarding damages against Defendants including all fees paid to them by Plaintiffs and the Funds for all periods not precluded by any applicable statutes of limitation through the trial of this case, together with interest, costs, disbursements, attorneys’ fees, and such other items as may be allowed to the maximum extent permitted by law; and

d. Such other and further relief as may be proper and just.

By: s/ Wm. Dirk Vandever

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Attorneys for Plaintiff

DEMAND FOR JURY TRIAL

Plaintiffs hereby demand a jury trial on all issues.

s/ Wm. Dirk Vandever
Attorneys for Plaintiff

40-33



AMERICAN CENTURY.

April 23, 2004



VIA FEDERAL EXPRESS

American Century
Investment
Management, Inc.

Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

RE: American Century Investment Management, Inc. ("ACIM")

P.O. Box 418210
4500 Main Street
Kansas City, MO
64141-9210

Ladies and Gentlemen:

1-800-345-2021
or
816-531-5575

Accompanying this letter for filing pursuant to Section 33 of the Investment Company Act of 1940, as amended, is a copy of the Complaint filed in connection with a derivative action brought against ACIM on behalf of certain registered investment companies advised by ACIM.

Should you have any questions or concerns regarding this filing, please contact the undersigned at (816) 340-7276.

www.americancentury.com

Sincerely,

Brian L. Brogan
Vice President and
Assistant General Counsel

BLB:ce

**UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF MISSOURI
CENTRAL DIVISION**

ROBERT L. BAKER, CHARLYNE VAN
OOSBREE, RANDAL C. BREVER,
DONALD HOLCOMB, and LINDA BAILEY,

Plaintiffs,

v.

Case No. 04-4039-CV-C-NKL

AMERICAN CENTURY INVESTMENT
MANAGEMENT, INC. and AMERICAN
CENTURY INVESTMENT SERVICES, INC.,

JURY TRIAL DEMAND

Defendants.

COMPLAINT

Plaintiffs, Ronald L. Baker, Charlyne Van Oosbree, Randal C. Brever, Donald Holcomb, and Linda Bailey, for the use and benefit of the American Century Select Fund, American Century Growth Fund, American Century Ginnie Mae Fund, American Century Giftrust Fund and American Century Ultra Fund, sue Defendants, American Century Investment Management, Inc. and American Century Investment Services, Inc., and allege:

I. JURISDICTION AND VENUE

1. This action is a derivative action brought by Plaintiffs on behalf of the American Century Select Fund, American Century Growth Fund, American Century Giftrust Fund and American Century Ultra Fund (collectively, the "Funds") pursuant to § 36(b) of the Investment Company Act of 1940 ("ICA"), as amended, 15 U.S.C. § 80a-35(b).

2. This Court has subject matter jurisdiction pursuant to 15 U.S.C. § 80a-43, 15 U.S.C.

§ 80a-35(b)(5), and 28 U.S.C. § 1331.

3. Venue is proper in this judicial district pursuant to 15 U.S.C. § 80a-43 and 28 U.S.C. § 1391(b)(2)-(3). Defendants are inhabitants of or transact business in this district, a substantial part of the events or omissions that give rise to Plaintiffs' claims occurred in this district, and Defendants may be found in this district.

4. All conditions precedent have been performed or have occurred.

II. BACKGROUND

5. Plaintiffs are shareholders in various open-end registered investment companies, or mutual funds (collectively the "Funds"), created, sold, advised, and managed with other funds as part of a fund family or complex by Defendants (the "Fund Complex"). Defendants, as the underwriters, distributors, advisors, and control persons of the Funds, owe fiduciary and other duties to Plaintiffs and all shareholders of the funds in the Fund Complex.

6. Plaintiffs and other shareholders of the Funds pay Defendants fees for providing pure investment advisory services and administrative services. These fees are based on a percentage of the net assets of each of the Funds. Defendants typically charge a combined fee for the pure investment advisory services and the administrative services.

7. The pure investment advisory services Defendants provide to the Funds are identical to the investment advisory services Defendants provide to other clients, such as institutional and sub-advisory clients, and entail identical costs. In fact, the cost of advisors, analysts, research data, the physical plant, and other aspects of Defendants' investment advisory services are shared between the mutual funds and the other clients.

8. Despite the equivalence of the investment advisory services Defendants provide

to the Funds and the other clients, the fees Defendants receive from the Funds that are attributable to pure investment advisory services are much higher than the fees Defendants or their affiliates receive from other clients for the identical services.

Section 36(b) of the Investment Company Act of 1940

9. In 1940, Congress enacted the Investment Company Act of 1940, 15 U.S.C. § 80a-1 et seq. (the "ICA"). The ICA was designed to regulate and curb abuses in the mutual fund industry and to create standards of care applicable to investment advisors such as Defendants. In the 1960s, it became clear to Congress that investment advisors to equity mutual funds were gouging those funds with excessive fees, particularly by not taking economies of scale into account. As a result, § 36(b), 15 U.S.C., § 80a-35(b), was added to the ICA in 1970, which created a federal cause of action for breach of fiduciary duty.

10. Section 36(b) provides in pertinent part:

[T]he investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company, or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser. An action may be brought under this subsection by the Commission, or by a security holder of such registered investment company on behalf of such company, against such investment advisers, or an affiliated person of such investment adviser, or any other person enumerated in subsection (a) of this section who has a fiduciary duty concerning such compensation or payments, for breach of fiduciary duty in respect to such compensation or payments paid by such registered investment company or by the security holders thereof to such investment adviser or person. . . .

11. In the past decade, the assets managed by Defendants within the Fund Complex have grown dramatically.

a. In 1993, the Fund Complex (exclusive of money market funds) had average

net assets of approximately \$22 billion and fund shareholders paid \$203 million, or 91 basis points, in advisory fees. Ten years later, by 2002, the Fund Complex (exclusive of money market funds) had significantly grown to nearly \$64 billion in average net assets. In spite of this sizeable increase in assets, advisory fees in 2002 had increased to \$597 million, or 93 basis points. For the Fund Complex as a whole, therefore, advisory fees actually *increased* as a percentage of average net assets from 1993 to 2002.

b. In 1993, the American Century Ultra Fund had \$6 billion in average net assets; by 2002, the fund had grown to \$24.4 billion, a more than four fold increase. Despite this huge increase in assets, advisory fees for the American Century Ultra Fund decreased only slightly as a percentage of average net assets, from 100 basis points in 1993 to 98 basis points in 2002.

12. While the Funds have grown dramatically in size, the nature of the services rendered by Defendants has changed little, if at all. Indeed, advances in computing and communication technologies in the past twenty years have resulted in exponential efficiencies that have dramatically reduced the costs of servicing mutual funds in ways Congress could not have imagined when it enacted ICA § 36(b). Nonetheless, the advisory fees paid to Defendants have grown dramatically. As a result, the advisory fees paid to Defendants (and accepted by them in violation of their statutory fiduciary duties) are disproportionately large in relationship to the services rendered to Plaintiffs.

13. In addition, Defendants, in violation of their fiduciary duties to Plaintiffs, have retained excess profits resulting from economies of scale. These economies of scale are a product of the dramatic growth in assets managed by Defendants. As assets under management increase,

the cost of providing services to additional assets does not increase at the same rate, resulting in tremendous economies of scale. In fact, with very large funds (such as the American Century Ultra Fund), the cost of servicing the additional assets approaches zero. Accordingly, any fees received in connection with the additional assets represent almost pure profit. The excess profits resulting from economies of scale belong to Plaintiffs and the other shareholders of the Funds.

14. The fees paid to Defendants are technically approved by the Funds' board of directors. A majority of the Funds' board[s] [is/are] comprised of statutorily presumed "disinterested" directors as that term is defined in § 10 of the ICA. Regardless of whether these presumably "disinterested" directors meet the requirements of § 10 of the ICA, there is a lack of conscientiousness by the directors in reviewing the advisory and distribution fees paid by each of the Funds. In addition, even if statutorily disinterested, the directors are in all practical respects dominated and unduly influenced by Defendants in reviewing the fees paid by Plaintiffs and other shareholders of the Funds. In particular, Defendants do not provide the directors with sufficient information for the directors to fulfill their obligations, a factor supporting a finding that Defendants have breached their fiduciary duties.

15. Although the fees challenged in this lawsuit may appear to the Court to be very small on a shareholder-by-shareholder basis, they cause a dramatic decrease in Plaintiffs' investment returns over time. Arthur Levitt, past Chairman of the Securities and Exchange Commission ("SEC"), was critical of what he called the "tyranny of compounding high costs":

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

Arthur Levitt, Jr., Inaugural address: Costs Paid with Other People's Money, Address at

Fordham University School of Law (Nov. 3, 2000), in 6 Fordham J. Corp. & Fin. L. 261, 267 (2001).

Nature of Claims

16. In this action, Plaintiff seeks to rescind the investment advisory agreements and to recover the total fees charged by Defendants or, alternatively, to recover the excess profits resulting from economies of scale wrongfully retained by Defendants and to recover other excessive compensation received by, or improper payments wrongfully retained by, Defendants in breach of their fiduciary duty under the ICA § 36(b), 15 U.S.C. § 80a-35(b). Because the conduct complained of herein is continuing in nature, Plaintiffs seek recovery for a period commencing at the earliest date in light of any applicable statute of limitations through the date of final judgment after trial.

17. No pre-suit demand on the board of directors of the Funds is required, as the requirements of F.R.C.P. 23.1 do not apply to actions under § 36(b) of the ICA. *Daily Income Fund v. Fox*, 464 U.S. 523 (1984).

II. PARTIES

18. Plaintiff Ronald L. Baker is a resident of Jefferson City, Missouri. He is a shareholder at all relevant times of the American Century Select Fund.

19. Plaintiff Charlyne Van Oosbree is a resident of Jefferson City, Missouri. She is a shareholder at all relevant times of the American Century Growth Fund, the American Century Select Fund and the American Century Ginnie Mae Fund.

20. Plaintiff Randal C. Brever is a resident of Seffner, Florida. He is a shareholder at all relevant times of the American Century Ultra Fund.

21. Plaintiff Donald Holcomb is a resident of Jefferson City, Missouri. He is the grantor of a trust for the benefit of his grandchildren which at all relevant times owns shares of the American Century Giftrust Fund.

22. Plaintiff Linda Bailey is a resident of Jefferson City, Missouri. She is a shareholder at all relevant times of the American Century Ultra Fund.

23. Defendant American Century Investment Management, Inc. (the "Adviser") is a Delaware corporation and is registered as an investment adviser under the Investment Advisers Act of 1940. The Adviser is the investment adviser to each of the Funds.

24. Defendant American Century Investment Services, Inc. (the "Distributor") is a Delaware corporation and is the distributor of the Funds. The distributor is registered as a broker-dealer under the laws of Missouri and is the distributor and principal underwriter of the Funds.

IV. GENERAL ALLEGATIONS

25. The test for determining whether compensation paid to Defendants violates § 36(b) is "essentially whether the fee schedule represents a charge within the range of what would have been negotiated at arm's-length in the light of all of the surrounding circumstances." *Gartenberg v. Merrill Lynch Asset Management, Inc.*, 694 F.2d 923, 928 (2d Cir. 1982). In order to violate § 36(b), "the advisor-manager must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining." *Id.*

26. In applying this test, all pertinent facts must be weighed in determining whether a fee or other compensation violates § 36(b). The *Gartenberg* court specifically identified six

factors (a portion of “all pertinent facts”) to be considered in determining whether a fee is so disproportionately large that it bears no reasonable relationship to the services rendered. These factors include: (1) the nature and quality of the services rendered; (2) the profitability of the funds to the advisor/manager; (3) economies of scale; (4) comparative fee structures; (5) fallout benefits (i.e. indirect profits to the advisor/manager resulting from the existence of the funds; and (6) the care and conscientiousness of the directors. A review of these factors, and the facts in this case, demonstrates that the fees charged by Defendants to the Funds violate § 36(b).

(1) The Nature and Quality of the Services Provided to the Funds

27. The nature of the investment advisory services provided to the Funds is straightforward: Defendants buy and sell, at their discretion, stocks, bonds, and other securities for the Funds. This is precisely the same service provided to Defendants’ institutional and other clients (albeit at a dramatically lower cost). On information and belief, the materials provided by Defendants to the directors of the Funds establish that the nature of these services has remained unchanged despite dramatic growth in the assets of the Funds and advisory revenues.

28. Despite the fact that the Funds receive identical investment advisory services as Defendants’ sub-advisory, institutional and other clients, on information and belief, Plaintiffs pay Defendants dramatically higher fees because these fees are not negotiated at arm’s length as they are with the other clients. This disparity in fees evinces Defendants’ willingness and determination to prefer their own financial interests to the interests of the Funds and the shareholders of the Funds.

29. On information and belief, Defendants repeatedly put their own financial interests ahead of the interests of the Funds and the shareholders of the Funds by participating in

arrangements and schemes that benefit Defendants at the expense of the Funds and their shareholders. The cost of this conflict of interest, which does not exist in the case of the arm's-length relationships, is manifest not only in higher fees, but in other losses and expenses borne by the Funds and the shareholders of the Funds. These losses and expenses directly impact the quality of the investment advisory services Defendants provide to the Funds

(2) The Profitability of the Fund to the Adviser/Manager

30. “[T]he ‘profitability of the fund to the adviser’ [must] be studied in order that the price paid by the fund to its adviser be equivalent to ‘the product of arm’s-length bargaining.’” See John P. Freeman & Stewart L. Brown, *Mutual Fund Advisory Fees: The Cost of Conflicts of Interest*, 26 J. Corp L. 610, 661 (2001) (the “Freeman & Brown Study”) (citing *Gartenberg*) [Ex. 1]. The profitability of a fund to an adviser-manager is a function of revenues minus the costs of providing services. However, upon information and belief, Defendants' reporting of their revenues and costs is intended to, and does, obfuscate Defendants' true profitability. For instance, upon information and belief, Defendants employ inaccurate accounting practices in their financial reporting, including arbitrary and unreasonable cost allocations.

31. Defendants true profitability can be determined on either an incremental basis or a full-cost basis. Defendants' incremental costs of providing advisory services to Plaintiffs are nominal, while the additional fees received by Defendants are hugely disproportionate given that the nature, quality, and level of the services remain the same. On information and belief, a review of Defendants' full costs of providing advisory services will also demonstrate the enormous profitability to Defendants of managing the Funds.

(3) Economies of Scale

32. The existence of economies of scale in the mutual fund industry has been recently confirmed by both the SEC and the Governmental Accounting Office (the “GAO”). Both conducted in-depth studies of mutual fund fees in 2000, and both concluded that economies of scale exist in the provision of advisory services. *See* SEC Division of Investment Management: Report on Mutual Fund Fees and Expenses (Dec. 2000) (“SEC Report”), at 30-31 [Ex. 2]; GAO, Report on Mutual Fund Fees to the Chairman, Subcommittee on Finance and Hazardous Materials; and the Ranking Member, Committee on Commerce, House of Representatives (June 2000) (“GAO Report”), at 9 [Ex. 3].

33. In addition, the most significant academic research undertaken since the Wharton School study in the 1960s establishes the existence of economies of scale that are not being passed along to mutual fund shareholders in violation of Defendants’ duty to do so under § 36(b) and Rule 12b-1. *See* Freeman & Brown Study” [Ex. 1]. As the Freeman & Brown Study noted: “The existence of economies of scale has been admitted in SEC filings made by fund managers and is implicit in the industry’s frequent use of fee rates that decrease as assets under management increase. Fund industry investment managers are prone to cite economies of scale as justification for business combinations.” *Id.* at 620 [Ex. 1].

34. These economies of scale exist not only fund by fund but also exist with respect to an entire fund complex and even with respect to an investment advisor’s entire scope of operations, including services provided to institutional, sub-advisory and other clients. *See* Freeman & Brown Study at 621 n.62 (quoting Victoria E. Schonfeld & Thomas M.J. Kerwin, Organization of a Mutual Fund, 49 Bus. Law 107 (1993)) [Ex. 1].

35. The clearest example of economies of scale occurs when total assets under

management increase due purely to market forces (without the institution of new advisory relationships or new asset gathering). In such instances, as the GAO confirms, it is possible for the advisor to service the additional assets with zero additional costs. See GAO Report at 9 (noting that growth from portfolio appreciation is unaccompanied by costs) [Ex. 3]. In other words, an investment advisor can advise a fund that doubles in size purely because of market forces with no increased costs because the services are unchanged. See GAO Report at 9 [Ex. 3]; Freeman & Brown Study at 619 n.43, 621 (noting that investment advisors have benefited by garnering “increased fees from the general increase in market prices with no commensurate efforts on their part” and also noting that as much as 64% of mutual fund asset growth has come from appreciation of portfolio securities, which, unlike growth from share sales to new investors, is costless) [Ex. 1].

36. From 1993 through 2002, Defendants’ assets under management grew from \$22 billion to nearly \$64 billion, an increase of nearly two and a half times. However, this phenomenal growth in mutual fund assets not only produced no economies of scale, but fees for the Fund Complex as a whole actually increased faster than the growth in assets. Fees went from \$203 million in 1993 to \$597 million in 2002. Fees as a percentage of average net assets increased from 91% in 1993 to 93% in 2002. The foregoing figures make a mockery of the concept of economies of scale.

37. Further evidence of Defendants’ refusal to pass along economies of scale to Plaintiffs and other shareholders of the Funds is the advisory fee breakpoint levels for the Funds. For example, the advisory fee structure for the American Century Ultra Fund, Investor Class Shares, is currently 1.00% (100 basis points) of the first \$20 billion in assets, .950% (95 basis

points) of the next \$10 billion, .925% (92.5 basis points) of the next \$10 billion, and .900% (90 basis points) of assets in excess of \$40 billion. The first breakpoint occurs, then, when the fund reaches *\$20 billion* in assets. By way of contrast, when Defendants' act as sub-advisors to mutual funds controlled by third parties, the first breakpoint in their sub-advisory fee typically begins at the \$50 million - \$100 million level. (See paragraph 42, *infra*.)

38. The economies of scale enjoyed by Defendants with respect to the Funds have not been shared with Plaintiffs as required by § 36(b). As a result, the fees paid to Defendants for advisory services provided to the Funds are grossly disproportionate to those services, are excessive, and violate § 36(b).

(4) Comparative Fee Structures

39. The fees advisors receive from mutual funds for investment advisory services are directly comparable to, though much higher than, the fees advisors receive from other clients for the identical services. As the Freeman & Brown Study noted: "None of the leading advisory fee cases involved equity funds, and hence, none of the courts were confronted directly with the strong analogies that can be drawn between equity advisory services in the fund industry as compared to the pension field where prices are notably lower." Freeman & Brown Study at 653 [Ex. 1]. While a "manager may encounter different levels of fixed and variable research costs depending on the type of the portfolio, . . . the fundamental management process is essentially the same for large and small portfolios, as well as for pension funds and mutual funds. The portfolio owner's identity (pension fund versus mutual fund) should not logically provide a reason for portfolio management costs being higher or lower." Freeman & Brown Study at 627-28 [Ex. 1]. Indeed, "a mutual fund, as an entity, actually is an institutional investor. When it comes to fee

discrepancies, the difference between funds and other institutional investors does not turn on 'institutional status,' it turns on self-dealing and conflict of interest." Freeman & Brown Study at 629 n.93 [Ex. 1]. Accordingly, the "'apples-to-apples' fee comparisons between equity pension managers and equity fund managers can be most difficult and embarrassing for those selling advice to mutual funds." Freeman & Brown Study at 671-72 [Ex. 1].

40. More recently, New York's Attorney General surveyed two fund complexes and confirmed the existence of massive over-charging of fund advisory fees. Specifically, Mr. Spitzer testified before a Senate Subcommittee on January 27, 2004, as follows:

Putnam's mutual fund investors were charged 40 percent more for advisory services than Putnam's institutional investors. In dollar terms, what this fee disparity means is that in 2002 Putnam mutual fund investors paid \$290 million more in advisory fees than they would have paid had they been charged the rate given to Putnam's institutional clients, and these are for identical services.

There was a similar disparity in the advisory fees charged by Alliance. Once again, mutual fund investors were charged significantly higher advisory fees than institutional investors. Specifically, Alliance's mutual fund investors paid advisory fees that were twice those paid by institutional investors. In dollar terms, this means that Alliance investors paid more than \$200 million more in advisory fees than they would have paid had they been charged the rate given to Alliance's institutional clients.

41. On information and belief, the shareholders of the Funds at issue here are plagued by the same discriminatory over-charging by Defendants as the shareholders of the funds mentioned by Mr. Spitzer in his Senate testimony. Indeed, a number of relevant comparative fee structures clearly establish that Defendants are charging advisory fees to the Funds that are disproportionate to the value of the services rendered.

42. The Adviser serves as the sub-adviser to the AXP Partners Aggressive Growth Fund, and receives a fee of 50 basis points of the first \$100 million in assets, 45 basis points of the next \$150 million in assets, 40 basis points of the next \$250 million in assets, and 38 basis points of assets in excess of 500 million.

43. The Adviser serves as the sub-adviser to the IDEX American Century International Fund, and receives a fee of 60 basis points of the first \$50 million in assets, 55 basis points of the next \$100 million, 50 basis points of the next \$350 million in assets, and 45 basis points for assets in excess of \$500 million.

44. The Adviser serves as the sub-adviser to the IDEX American Century Income and Growth Fund, and receives a fee of 50 basis points of the first \$100 million in assets, 45 basis points of the next \$150 million, and 40 basis points of assets in excess of \$250 million.

45. An affiliate of the Defendants performs institutional investment advisory services. The fee charged for investment advisory services rendered to the Arizona State Retirement System for managing an active large cap equity account with \$1.1 billion in assets was just 14 basis points in 1999. The fee charged for investment advisory services rendered to the New York State Common Retirement Fund for managing a large cap equity account with \$1.4 billion in assets was just 16.7 basis points in 1999.

(5) Fallout Benefits

46. Defendants indirectly profit because of the existence of the Funds through fallout benefits. Obvious, but difficult to quantify fallout benefits include the attraction of new customers, cross selling related funds to current customers, and other benefits associated generally with the development of goodwill and the growth in assets of the Funds.

47. Other, easier to quantify, benefits include “soft dollars” payable from broker-dealers. Essentially, “soft dollars” are credits furnished to Defendants from broker-dealers and other securities-industry firms in exchange for routing the Funds’ securities transaction orders and other business to paying firms. These soft-dollar credits should be used to purchase research and

other goods or services that benefit the shareholders of the Funds. On information and belief, however, the soft-dollar arrangements benefit Defendants and result in increased costs to the shareholders of the Funds with little to no corresponding benefits to the shareholders of the Funds. On information and belief, the soft dollar arrangements are concealed from the shareholders of the Funds in breach of Defendants' fiduciary duty.

48. On information and belief, Defendants also receive "kickbacks," either directly or indirectly, as transfer agency and custodian fees grow due to increases in the assets of the Funds and the number of shareholders.

49. On information and belief, Defendants receive further fallout benefits from securities lending arrangements. Essentially, Defendants loan out the securities of the Funds and receive compensation as the lending agents of the Funds.

50. A highly profitable fallout benefit to Defendants is the ability to sell investment advisory services paid for by the Funds at virtually no additional cost. Much like computer software, once the investment research and resulting recommendations are paid for, that research and those recommendations may be sold to other clients at virtually no cost whatsoever to Defendants. Without payment by Plaintiffs and other shareholders of the Funds of millions of dollars in advisory and distribution fees (especially distribution fees that are nothing more than a means to extract additional compensation for advisory services), Defendants would have to pay to conduct that research independently in order to provide investment advisory services to other clients, including institutional clients. This is a natural byproduct of the extraordinary economies of scale inherent in the investment advisory business. However, although Plaintiffs and other shareholders of the Funds pay all of the costs associated with the investment advisory services,

Defendants resell these services to third parties without compensating Plaintiffs through reduced fees or in any other way.

51. On information and belief, Defendants do not provide sufficient information regarding the existence and extent of these and other fallout benefits to the shareholders of the Funds or to the Funds' directors. The directors are thus unable to quantify or even meaningfully consider the benefits. Plaintiffs and other shareholders of the Funds have paid for these benefits and are entitled to compensation in the form of reduced advisory fees and the elimination of distribution fees.

(6) The Independence and Conscientiousness of the Directors

52. At least 40% of the Funds' directors must be "disinterested" as defined in § 10 of the ICA. As the GAO Report noted, the structure of most mutual funds embodies a potential conflict of interest between the fund's shareholders and its adviser. This conflict arises because the fees paid by the shareholders represent revenue to the adviser. The United States Supreme Court has stated that the disinterested-director requirement is "the cornerstone of the ICA's efforts to control" this conflict of interest. *Burks v. Lasker*, 441 U.S. 471 (1979).

53. The disinterested directors are supposed to serve as "watchdogs" for the shareholders of the Funds. As such, the disinterested directors have primary responsibility for, among many other things, negotiating and approving all contracts and agreements with Defendants and reviewing the reasonableness of the advisory and distribution fees received by Defendants. Accordingly, as noted by the GAO, the directors are expected to review, among other things, the advisor's costs, whether fees have been reduced when the Funds' assets have

grown, and the fees charged for similar services. See GAO Report at 14 [Ex. 3]. These responsibilities are intensive, requiring the directors to rely on information provided by Defendants. Defendants, in turn, have a fiduciary duty to provide all information reasonably necessary for the directors to perform their obligations. See 15 U.S.C., § 80a-15(c); 17 C.F.R. § 270.12b-1.

54. The ICA contains a presumption that the disinterested directors are in fact disinterested. However, the lack of conscientiousness of even disinterested directors in reviewing the fees paid by the Funds, the lack of adequate information provided to the directors in connection with their approvals of the advisory agreements and Distribution Plans, and the control of management over the directors in reviewing the fees paid by the Funds are not presumed but, rather, are important factors recognized in the *Gartenberg* line of cases in determining whether Defendants have breached their fiduciary duties. In addition, the SEC has specifically recognized that even disinterested directors may not be independent but, rather, may be subject to domination or undue influence by a fund's investment adviser. For example, the SEC has stated that "disinterested directors should not be entrusted with a decision on use of fund assets for distribution without receiving the benefit of measures designed to enhance their ability to act independently." *Bearing of Distribution Expenses by Mutual Funds*, Investment Co. Act Rel. No. 11414, 1980 SEC LEXIS 444 at *36 (Oct. 28, 1980).

55. Two noteworthy industry insiders have commented on the general failure of mutual fund boards to fulfill their responsibilities under the ICA. Jack Bogle, founder of the Vanguard Group, made the following comment:

Well, fund directors are, or at least to a very major extent, sort of a bad joke. They've watched industry fees go up year after year, they've added 12b-1 fees. I think they've forgotten, maybe they've never been told, that the law, the 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.

Warren Buffet, famous investor and chairman of Berkshire Hathaway, Inc. made the following comment, which was recently quoted by a United States District Court:

I think independent directors have been anything but independent. The Investment Company Act, in 1940, made these provisions for independent directors on the theory that they would be the watchdogs for all these people pooling their money. The behavior of independent directors in aggregate since 1940 has been to rubber stamp every deal that's come along from management—whether management was good, bad, or indifferent. Not negotiate for fee reductions and so on. A long time ago, an attorney said that in selecting directors, the management companies were looking for Cocker Spaniels and not Dobermans. I'd say they found a lot of Cocker Spaniels out there. *Strougo v. BEA Assoc.*, 188 F. Supp.2d 373, 383 (S.D.N.Y. 2002) (citation omitted).

Mr. Buffet has also stated, in his letter to shareholders in the 2002 Berkshire Hathaway, Inc. annual report:

[A] monkey will type out a Shakespeare play before an "independent" mutual-fund director will suggest that his fund look at other managers, even if the incumbent manager has persistently delivered substandard performance. When they are handling their own money, of course, directors will look to alternative advisors – but it never enters their minds to do so when they are acting as fiduciaries for others. . . . 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 negotiate materially lower management fees with the incumbent managers of most mutual funds. And, believe me, if directors were promised a portion of any fee savings they realized, the skies would be filled with falling fees. Under the current system, though, reductions mean nothing to "independent" directors while meaning everything to managers. So guess who wins? . . . [I]n stepping up to [their] all-important responsibilities, tens of thousands

of "independent" directors, over more than six decades, have failed miserably. (They've succeeded, however, in taking care of themselves; their fees from serving on multiple boards of a single "family" of funds often run well into six figures.) 2002 Berkshire Hathaway, Inc. Annual Report to Shareholders, p. 17 – 18.

56. As part of their scheme to receive excessive fees, Defendants did not keep the directors fully informed regarding all material facts and aspects of their fees and other compensation, and the directors failed to insist upon adequate information. For example:

c. On information and belief, Defendants provided virtually no information to the directors regarding the advisory fees charged to pension and other institutional clients or to other mutual funds being advised or sub-advised by Defendants.

d. On information and belief, Defendants provided virtually no information to the directors regarding the economies of scale enjoyed or fallout benefits received by Defendants.

e. On information and belief, the profitability data given to the board of directors provide no explanation as to how the board should evaluate economies of scale.

f. On information and belief, the directors rarely, if ever, question any information or recommendations provided by Defendants.

57. The foregoing assures that the directors do not understand Defendants' true cost structure and, in particular, the economies of scale enjoyed by them in providing investment advisory services to the Funds and their institutional and other clients.

58. On information and belief, the disinterested directors of the Funds have not receive the benefit of any measures to enhance their ability to act independently, which has caused the directors to be dependent on Defendants and has allowed Defendants to dominate

and unduly influence the directors. In addition, the directors' failure to insist on adequate information evinces a lack of care and conscientiousness on their part.

COUNT I
ICA §36(b)
BREACH OF FIDUCIARY DUTY
(Excessive Investment Advisory Fees)

59. Plaintiffs repeat and re-allege paragraphs 1 through 58, inclusive, of this complaint.

60. The fees charged by Defendants for providing advisory services to the Funds are and continue to be disproportionate to the services rendered and are not within the range of what would have been negotiated at arm's length in light of all the surrounding circumstances, including the advisory fees that Defendants charge their other clients.

61. In charging and receiving excessive or inappropriate compensation, and in failing to put the interests of Plaintiffs and the other shareholders of the Funds ahead of their own interests, Defendants have breached and continue to breach their statutory fiduciary duty to Plaintiffs in violation of ICA § 36(b).

62. Plaintiffs seek, pursuant to § 36(b)(3) of the ICA, the "actual damages resulting from the breach of fiduciary duty" by Defendants, up to and including, "the amount of compensation or payments received from" the Funds.

COUNT II
ICA § 36(b)
BREACH OF FIDUCIARY DUTY
(Excess Profits from Economies of Scale)

63. Plaintiffs repeat and re-allege paragraphs 1 through 58, inclusive, of this complaint.

64. Defendants have received and continue to receive excess profits attributable to extraordinary economies of scale.

65. By retaining excess profits derived from economies of scale, Defendants have breached and continue to breach their statutory fiduciary duty to Plaintiffs in violation of ICA § 36(b).

66. Plaintiffs seek, pursuant to § 36(b)(3) of the ICA, the “actual damages resulting from the breach of fiduciary duty” by Defendants, up to and including, the “amount of compensation or payments received from” the Funds.

WHEREFORE, Plaintiffs demand judgment as follows:

a. An order declaring that Defendants have violated and continue to violate § 36(b) of the ICA and that any advisory agreements entered into are void ab initio;

b. An order preliminarily and permanently enjoining Defendants from further violations of the ICA;

c. An order awarding damages against Defendants including all fees paid to them by Plaintiffs and the Funds for all periods not precluded by any applicable statutes of limitation through the trial of this case, together with interest, costs, disbursements, attorneys’ fees, and such other items as may be allowed to the maximum extent permitted by law; and

d. Such other and further relief as may be proper and just.

By: s/ Wm. Dirk Vandever

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DEMAND FOR JURY TRIAL

Plaintiffs hereby demand a jury trial on all issues.

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