

# **Bond Case Briefs**

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## **AUCTION RATE SECURITIES - NEW YORK**

### **Rotz v. Van Kampen Asset Management**

**Supreme Court, New York County, New York - October 22, 2014 - Slip Copy - 45 Misc.3d 1211(A) - 2014 N.Y. Slip Op. 51537(U)**

Shareholders in investment funds organized as business trusts under Massachusetts law (the “Trusts”) brought shareholder derivative suits alleging that the Trusts and the Trusts’ former investment advisers (“Adviser”) breached their fiduciary duties and wasted corporate assets by causing the trusts to redeem auction rate preferred securities (“ARPS”) at their liquidation value, at a time when the market valued the shares at a lower rate. Plaintiffs further alleged that Morgan Stanley, the parent company of the former investment advisers, aided and abetted the breaches.

These liquidations occurred in 2008 when the ARS market dried up. The Trusts, with the approval of their boards, used tender option bonds (TOBs) or debt financing to redeem the ARPS. Plaintiffs allege that TOBs and debt financing increased the costs and the risks to the Trusts without concomitant benefit. Specifically, TOBs forced the Trusts to sell lower grade bonds into a distressed market and to hold municipal bonds, which paid a lower interest rate and prevented the Trusts from making other investments which would have been more profitable. TOBs also required the Trusts to post more assets to satisfy the debt coverage ratio than the ARPS did and cost additional fees. Plaintiffs alleged that the Trusts could have marked the ARPS down below their liquidation value and redeemed them at market value at much lower cost to investors.

Plaintiffs contended that the Adviser gave priority to their own interests in determining to redeem the ARPS at liquidation value and, thus, breached their fiduciary duties to the common shareholders. Plaintiffs alleged that the redemption of the ARPS at liquidation value benefited ARPS holders—largely institutional investors and high net worth individuals, and broker-dealers—and that the Adviser sought to preserve their business relationships with those investors to the detriment of the shareholders of the Trusts.

In April 2010, plaintiffs sent letters to the Trusts demanding that the boards “take action” against the Adviser and the officers of the Trusts for alleged breaches of fiduciary duty, aiding and abetting of those breaches, and corporate waste.

The Trusts responded by forming special litigation committees (“SLCs”) comprised of independent trustees. The SLCs engaged independent counsel, conducted lengthy investigations, and produced voluminous reports concluding that it was not in the best interests of the Trusts to pursue litigation and recommending that the Trusts move to dismiss the pending lawsuits.

All defendants contended that, because the trustees were independent and conducted an investigation through the SLCs, the decision not to prosecute this action was protected by the business judgment rule, and the mandatory language of MBCA Section 7.44 compelled dismissal of this action.

Plaintiffs contended that the SLCs’ investigations and reports, upon which the determination not to proceed with litigation was indisputably based, were not undertaken in good faith after a reasonable

inquiry “because the evidence overwhelmingly disproves the SLC’s conclusions.”

The court noted that where a majority of independent trustees reject a plaintiff’s demand to pursue derivative litigation based on the report of an independent SLC, the business judgment rule applies to the decisions of both the trustees and the SLCs.

The court held that plaintiffs’ claims must be dismissed. Applying the burden shifting standards of MBCA section 7.44 and the business judgment rule in reviewing the SLCs’ investigations and the independent trustees’ determinations to reject plaintiffs’ demands based the recommendations, the court holds that plaintiffs had failed to rebut the Trusts’ showing and to demonstrate that the independent trustees’ determinations were not made in good faith after reasonable inquiry. The investigation process was reasonably comprehensive, and the SLCs’ findings, which the trustees’ adopted, were not illogical and could be attributed to a rational business judgment.

The court noted that the plaintiffs misconstrued the standard under the Massachusetts statute for judicial review of the trustees’ determinations. Plaintiffs contended repeatedly that the findings and recommendations of the SLCs were against the weight of the evidence. However, it is not the courts’ role to weigh the evidence or assess the correctness of the SLCs’ or trustees’ reasoning, where, as here, the decision of disinterested trustees, based on a comprehensive report of a disinterested special litigation committee, is protected by the business judgment rule.