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Calamos Fiduciary Case Gets Second Life in State Court

By Chris Frankie January 18, 2011

A class action lawsuit against **Calamos**, the **Calamos Convertible and High Income** closed-end fund, and its directors claiming breach of fiduciary duty and unjust enrichment has been given new life. The plaintiffs recently re-filed the case.

The re-filing is just the latest development in a court battle that began in August between the plaintiffs, **Rutgers Casualty Insurance Company**, and the Calamos contingent. That August case was filed in federal court and claimed that Calamos redeemed auction rate preferred shares (ARPS) to the detriment of the common shareholder but to the benefit of preferred shareholders and company management.

The plaintiffs said the ARPS were advantageous for the common shareholders to hang onto because they provided the fund with long-term financing and short-term interest rates. They also provided liquidity to the holders of the ARPS and flexibility to the fund and were perpetual because they had no maturity and did not have to be repaid.

“Despite the many benefits provided by the ARPS, which inured to the benefits of the Class, during 2008 the Individual Defendants caused the fund to partially redeem the ARPS and replace them with less favorable debt financing,” the lawsuit states. “The Individual Defendants took these actions to further their own interests and those of the fund’s investment adviser and its affiliates, not the interests of the common shareholders. They thereby breached their fiduciary duties owed to the fund’s common shareholders.”

In October, the plaintiffs voluntarily dismissed their claims against Calamos, the funds and directors. The case was later re-filed in the circuit court of Cook County Illinois.

The re-filed complaint claims the funds’ directors breached their fiduciary duty by approving the redemption of auction rate cumulative preferred shares and “recapitalizing the fund with debt-based borrowings that were allegedly less advantageous to the fund’s common shareholders,” according to a regulatory filing. Additionally, the newer complaint says that Calamos “aided and abetted” the directors’ breach of fiduciary duty and they were “unjustly enriched as a result.”

For its part, Calamos said in a statement that the Calamos Convertible and High Income Fund and other Calamos closed-end funds redeemed their outstanding auction market preferred shares (AMPS) in response to the “unprecedented collapse of the market for all auction rate securities during the financial crisis in 2008, which resulted in illiquidity for the holders of the AMPS and other auction rate securities and essentially eliminated auction rate securities as a viable source of future leverage for closed-end funds going forward.”

Calamos says it believes redeeming the shares was in the best interest of shareholders. Furthermore, the fund shop notes that the directors exercised appropriate business judgment and took the proper steps toward ensuring viable future leverage that prevented the liquidation of the portfolio.

Calamos Advisors, Calamos Asset Management, the Calamos **Convertible Opportunities and Income Fund** and the Calamos Convertible and High Income Fund, as well as current and former directors of the two funds have been named as defendants in three class action suits. Calamos says the suits should be dismissed.

“The directors were faced with a problem that came out of the blue where they had to make a judgment,” says Carl Frischling, a partner at **Kramer Levin Naftalis & Frankel**, of the 2008 credit crunch. “Their decision was to redeem the ARPS when they had an opportunity to. In this case, management and the board went along with it.”

With the auction rate preferreds, there was no liquidity, and there were no substitutes for the auction rates, observed Frischling. “Some other groups came up with alternatives, but in this case they agreed to a redemption. The common shareholders felt the preferred shareholders benefited to the detriment of the common shareholders.”

Essentially it comes down to business judgment, observers note. Directors and firms have successfully warded off such lawsuits in the past under the business judgment rule, Frischling says. “In effect, boards are entitled, if they are independently advised and do their due diligence, to make a judgment. Courts have said they are not going to substitute their view for that of the board.” In some cases, there is no independent input and the board hides behind “business judgment,” but that’s not the case with Calamos, which is a substantial fund group, Frischling says. Directors have broad discretion under the business judgment rule.

The plaintiffs realized that they didn’t have federal jurisdiction and decided to drop that case and re-file in state court, says Robert Skinner, partner in the securities litigation group at **Ropes & Gray**. There was a similar case against **Eaton Vance** in the district of Massachusetts in which they dropped the lawsuit due to jurisdictional issues. “Not too long thereafter, the plaintiffs in the Calamos case did the same thing, withdrawing their case to re-file it in state court,” Skinner says. “I think they realized they didn’t have federal jurisdiction to bring these state law claims.”

In addition to the jurisdiction issue, the plaintiffs face another significant hurdle. “One of the issues that is going to be disputed in this case, which was also briefed in the Eaton Vance case, is can these shareholders bring this claim on their own behalf or does it have to be on behalf of the fund? Plaintiffs in such cases generally have to bring the case on behalf of the fund in what is known as a derivative lawsuit. It generally cannot be brought on behalf of individuals,” he continues.

However, in order to sue on behalf of the fund, the plaintiffs must first make a demand on the board to bring the case themselves. “If you make a demand on the trustees and the claim is against the trustees, you’re asking the trustees to sue themselves on behalf of the fund. I think the obvious answer from the board is going to be ‘no, we considered this and only sold the ARPS after we were comfortable that it was sufficient with our duties,’” Skinner says.

Niels Holch, executive director of the **Coalition of Mutual Fund Investors**, says that directors need to be especially diligent about their fiduciary duty in the current environment. “During financial crises, you see more lawsuits as people try and rectify wrongs,” he says, noting that directors could wind up in state court.

While the Calamos case appears to have some new life – this time in state court – Frischling says it may provide some insight into how similar cases may play out in the courts. “There are a number of other cases that are pending with similar fact patterns. The nature of the funds is different, but most of the cases involve income-oriented funds.”

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