CLIENT MEMORANDUM

New York Court Rejects Challenge to Kenneth Cole Going Private Transaction, Applies Business Judgment Rule, And Confirms Rights of Controlling Stockholders Under New York Law

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On September 3, 2013, a New York trial court dismissed a stockholder challenge to a going private transaction in which Kenneth Cole, who held approximately 47% of the Company's outstanding common stock and controlled 90% of the voting power of Kenneth Cole Productions Inc. ("KCP"), purchased the remaining 53% of the common stock of KCP that he did not already own. Our firm represented Mr. Cole in the underlying going private transaction and the class action litigation that ensued.

The Facts

On February 24, 2012, KCP announced that Mr. Cole had proposed a transaction to take KCP private and to pay the public stockholders $15.00 per share, which reflected a 17% premium to KCP's unaffected share price. KCP's board created a special committee of four independent directors to negotiate with Mr. Cole, who conditioned his bid on the approval of the special committee and the affirmative vote of a majority of the minority stockholders. Mr. Cole made it publicly clear that he would not entertain any offers to sell his shares in a third party transaction and was only interested in buying shares from the minority stockholders. After several months of negotiations, Mr. Cole agreed to pay $15.25 per share. 99.8% of KCP's shares unaffiliated with Mr. Cole that voted ultimately voted in favor of the transaction.

Plaintiffs, a class of KCP minority stockholders, filed lawsuits alleging that the KCP directors breached their fiduciary duties by agreeing to a price that was unfair to the minority stockholders and had resulted from an unfair process because, inter alia, the special committee was not truly independent. The stockholders further claimed that Mr. Cole breached his fiduciary duties because he had bargained hard with the special committee to pay as little as possible, and had announced that he was unwilling to sell his shares to a third party, thus negatively impacting the value that the minority stockholders could receive for their shares.

The Ruling

Justice Lawrence Marks of the New York State Supreme Court, Commercial Division, applying New York law, dismissed all of Plaintiffs' claims. The opinion is noteworthy for several reasons.

First, the Court applied the deferential business judgment rule, rather than some higher "entire fairness" standard advocated by the minority stockholders, to the special committee's decision to approve, and the KCP board's decision to consummate, the transaction at $15.25 per share.

Second, the Court confirmed that the election of directors to a board by a controlling stockholder did not automatically render such directors beholden to the controlling stockholder and, therefore, lacking independence.

Third, the Court confirmed that special committees are not required to engage in futile acts and the KCP special committee did not breach its fiduciary duties by failing to solicit other offers because it was clear that Mr. Cole would reject them (as he was entitled to do). Applying the business judgment rule, the Court concluded that "even assuming that a higher price might have been possible, that does not render the special committee's actions a violation of their fiduciary duties. At most, plaintiffs have alleged that they disagree with the manner in which the special committee pursued negotiations with Cole and are dissatisfied with the result. However, such dissatisfaction does not suggest that the process was unfair or demonstrate that a duty of trust was violated…." The Court reiterated that "absent a showing of specific unfair conduct by the special committee, the Court will not second guess the committee's business decisions in negotiating the terms of a transaction."

Finally, as to Mr. Cole, the Court confirmed that while Mr. Cole owed a fiduciary duty to the minority stockholders, there were no particularized allegations that such a duty was breached. The Court rejected the assertion that Mr. Cole's announcement that he was not a seller, only a buyer, undermined the special committee's ability to seek out other possible sales at higher prices. The Court held that a controlling stockholder was not required to acquiesce in a transaction just because it would benefit the minority stockholders and that "the ability to resist such a transaction would appear to be one of the benefits of having a controlling position in the company." The Court also rejected the allegation that Mr. Cole had acted improperly by striving to negotiate as low a price as possible for the buyout, concluding that New York law does not require a controlling stockholder "to subvert his own economic interest, in obtaining a low price, to the minority shareholders' interest in obtaining a higher price."

Conclusion

Most of the law in this area has been developed by the Delaware courts and, thus, the Kenneth Cole opinion is a welcome application of New York law by a New York court to a going private transaction involving a controlling stockholder. The Kenneth Cole decision confirms that, absent a particularized allegation of *specific unfair conduct*, the business judgment rule will apply to going private transactions involving controlling stockholders, and that the New York courts will not second-guess business decisions by a special committee. Simply disagreeing with the price obtained, or the negotiation strategy followed, by a special committee should not be sufficient for a minority stockholder to pursue litigation. The Kenneth Cole decision further highlights the longstanding rule under New York law that controlling stockholders have an absolute right to act in their own economic interest, so long as they do not engage in self-dealing or similar conduct. Finally, the Kenneth Cole decision also makes clear that properly structuring a transaction at the outset with appropriate protections for minority stockholders is very important to ensure that any transaction receives protection of the business judgment rule in subsequent litigation.

Clients having questions about the Kenneth Cole opinion should call Tariq Mundiya (212-728-8565, tmundiya@willkie.com), Sameer Advani (212-728-8587, sadvani@willkie.com) or the Willkie attorney with whom they regularly work.

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