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CLIENT MEMORANDUM

New York Appeals Court Applies Business Judgment Rule to Going Private Transaction Involving Controlling Stockholder Under New York Law

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On November 20, 2014, the New York Appellate Division, First Department, in a case of first impression under New York law, ruled in favor of Kenneth Cole in a litigation where minority shareholders had challenged the fashion designer's transaction to take private Kenneth Cole Productions, Inc. Mr. Cole controlled approximately 89% of KCP's voting power and owned a 46% economic interest in KCP. Willkie Farr & Gallagher LLP represented Mr. Cole in the transaction and the class action litigation. (Litigation partner Tariq Mundiya argued the case for Mr. Cole at the trial and appellate levels.)

The Appellate Division found that the business judgment standard of review – and not the heightened entire fairness standard – applied to judicial review of breach of fiduciary claims because the transaction had been structured at the outset with dual protections of an independent special committee review and the vote of a "majority of the minority" (that is, non-Cole) shareholders. The judicial standard of review can have important litigation consequences, as cases governed by the business judgment rule can be dismissed at an early stage, as occurred here, whereas transactions governed by the "entire fairness" standard generally require discovery and further proceedings, which can be burdensome and expensive.

Factual Background

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, on behalf of a putative 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, among other things, 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 Appellate Division Ruling

Affirming the trial court's dismissal of the complaint against all defendants (including Mr. Cole and KCP's directors), the Court found that "the motion court was not required to apply the 'entire fairness' standard to the transaction[.]" Rather, it was appropriate to apply the business judgment standard of review. Applying that standard, the Appellate Division affirmed the trial court's finding that plaintiffs had failed to allege facts supporting a claim that Mr. Cole or the independent directors had breached their fiduciary duties. In so holding, the Appellate Division distinguished the Court of Appeals' decision in *Alpert v. 28 Williams St. Corp.*, 63 N.Y.2d 557 (1984), which had applied the entire fairness standard to certain types of mergers. The Appellate Division noted that Mr. Cole's going-private transaction, unlike the transaction at issue in *Alpert*, "required approval of the majority of the minority (*i.e.*, non-Cole) shareholders."

The Appellate Division's decision in *Kenneth Cole* puts New York law in line with recent Delaware law. In *Kahn v. M&F Worldwide*, 88 A.3d 607 (Del. 2014), the Delaware Supreme Court recently held that the business judgment rule would apply to judicial review of a going-private transaction that is approved by an independent special committee and a fully informed vote of a majority-of-the-minority stockholders. Willkie represented the special committee of independent directors in *M&F Worldwide*.

The *Kenneth Cole* decision makes clear that properly structuring a going-private transaction at the outset – including with appropriate protections for minority stockholders – can be critical in ensuring that such transactions receive business judgment rule protection 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), Benjamin McCallen (212-728-8182, bmccallen@willkie.com) or the Willkie attorney with whom they regularly work.

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