CLIENT MEMORANDUM

New York's Highest Court Issues Landmark Ruling That the Business Judgment Standard of Review, Not Entire Fairness, Applies to Going-Private Transactions Involving Controlling Shareholders

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New York Court applies MFW ruling from Delaware in affirming dismissal of complaint challenging going private merger.

In a case of first impression, on May 5, 2016, the New York Court of Appeals in *In re Kenneth Cole Productions Shareholder Litig*., Apl. No. 2015-00155 (N.Y.), held that the business judgment rule — rather than the fact-intensive "entire fairness" standard — applied to going-private mergers involving controlling shareholders. Adopting the standard established by the Delaware Supreme Court in *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014) ("MFW"), the Court of Appeals affirmed the lower courts' dismissal of the action based upon the shareholder protections that Kenneth Cole had built into the structure of the transaction (which was handled by Willkie).

Litigation partners Tariq Mundiya (who argued the case for Kenneth Cole), Sameer Advani and Benjamin McCallen handled the shareholder litigation from inception. This landmark ruling, which puts New York and Delaware on the same footing, provides that going-private transactions involving controlling shareholders will get the benefit of the deferential business judgment standard of review if the transaction is approved by (1) an independent special committee and (2) a fully informed majority of the minority shareholders. This case establishes important precedent for future corporate transactions, and provides a roadmap to corporate attorneys structuring going-private transactions involving controlling shareholders under New York law. The case also provides important guidance for practitioners structuring transactions outside New York and Delaware because the highest courts in two states now have the same standard for review of going private transactions.

Background

The litigation was initiated by purported minority shareholders of Kenneth Cole Productions, Inc. ("KCP") in connection with a 2012 going-private transaction in which Kenneth Cole, then owner of 46% of KCP, sought to acquire the remaining 54% of outstanding KCP shares. From the outset, Mr. Cole expressly conditioned the transaction upon the approval of an independent Special Committee and a fully informed vote of a majority-of-the-minority shareholders. The Special Committee was fully empowered to reach its own conclusions, including to reject Mr. Cole's proposal outright. The Special Committee met eleven times, selected its own financial and legal advisors, and after extensive deliberation and negotiation, secured a bid of $15.25 per share — $.25 per share greater than Mr. Cole's initial offer. Three months later, an overwhelming 99.8% of the shareholders unaffiliated with Mr. Cole voted in favor of the transaction. Despite the work of the Special Committee and the resounding support for the transaction from the minority shareholders, plaintiffs proceeded to seek damages, alleging that the merger was unfair and that Mr. Cole and the independent directors had breached their fiduciary duties. All defendants moved to dismiss the complaint, and the trial court granted those motions in their entirety. Applying the business judgment rule, the trial court found that the complaint failed to state a claim against Mr. Cole or the independent directors, where Mr. Cole removed himself from the board's consideration of his offer and the transaction was conditioned at the outset on approval by an independent Special Committee and a fully informed vote of a majority-of-the-minority shareholders. In November 2014, the Appellate Division, First Department entered a decision unanimously affirming the trial court's order in its entirety.

New York Court of Appeals Ruling

The Court of Appeals affirmed the lower courts' decisions, adopting the standard set forth by the Delaware Supreme Court in *MFW.* Applying the *MFW* standard, the Court held that "'business judgment is the standard of review that should govern mergers between a controlling stockholder and its corporate subsidiary, where the merger is conditioned *ab initio* upon both the approval of an independent, adequately-empowered Special Committee that fulfills its duty of care; and the uncoerced, informed vote of a majority of the minority stockholders.'" The Court found this standard properly balanced the rights of minority shareholders against "the interests of directors and controlling shareholders in avoiding frivolous litigation and protecting independently-made business decisions from unwarranted judicial interference."

Applying this standard here, the Court found that "[p]laintiff did not sufficiently and specifically allege that any of MFW's" procedural protections "were absent from the merger." Therefore, review under the business judgment standard was appropriate, and "[i]nasmuch as no fraud or bad faith has been alleged here, the complaint was properly dismissed."

Partners Tariq Mundiya, Sameer Advani, and Benjamin McCallen, and associates Elizabeth Roache and Maxwell Bryer represented Kenneth Cole in the litigation.

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