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New York Adopts Delaware Standards of Review for Going-Private Mergers by Controlling Shareholders

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New York's highest court, in an opinion[1] issued yesterday, adopted as New York law the test established by the Delaware Supreme Court in *Kahn v. M&F Worldwide Corp. ("MFW")*[2] for applying the business judgment rule to the review of going-private transactions by controlling shareholders. This important decision clarifies the standards applicable to directors of New York corporations in such transactions and promotes the use of the protective majority-of-the-minority vote mechanism.

The *Kenneth Cole Productions ("KCP")* Decision

Background. Plaintiffs, putatively representing a class of shareholders of Kenneth Cole Productions, Inc., challenged the decisions of a special committee of the board of directors in negotiating a buyout transaction with company founder and controlling shareholder Kenneth Cole. Mr. Cole, who owned shares representing 89% of the voting power of KCP, proposed a going-private transaction conditioned from the outset on approval of a special committee and of a majority-of-the-minority shareholders. The transaction, following an extended negotiation, was eventually approved by 99.8% of the minority shareholders.

Opinion. Upholding the judgments of the Supreme Court and Appellate Division dismissing the claims, including allegations of a lack of independence or effectiveness of the members of the special committee, the Court of Appeals declined to apply the "entire fairness standard" of review established by that Court's "seminal decision regarding freeze-out mergers," *Alpert* v. *28 Williams St. Corp*,[3] and instead adopted the six-part *MFW* test, under which the business judgment rule will apply to a court's review of controller buyouts if (1) the controller conditions the transaction on approval of a special committee and a majority-of-the-minority shareholders; the special committee (2) is independent; (3) is empowered to select its own advisors and to say no definitively to the deal; and (4) meets its duty of care in negotiating a fair price; and the minority shareholders are (5) informed; and (6) uncoerced.[4] The Court of Appeals reasoned that "the *MFW* standard properly considers the rights of minority shareholders . . . and balances them against the interests of directors and controlling shareholders in avoiding frivolous litigation and protecting independently-made business decisions from unwarranted judicial interference."[5] Finding the requirements of the *MFW* test met and no "fraud

[1] *In the Matter of Kenneth Cole Productions, Inc., Shareholder Litigation, No. 54*, 2016 WL 2350133, -- N.E.3d -- (N. Y. May 5, 2016).
[2] 88 A.3d 635 (Del. 2014).
[3] 63 N.Y.2d 557 (N.Y. 1984).
[4] *MFW*, 88 A.3d at 645.
[5] *KCP*, at 12-13.

or bad faith" alleged in the case at bar, the Court affirmed the lower courts' dismissal of plaintiffs' claims in deference to "the determinations of the special committee and the KCP board of directors."[6]

Conclusion

The *KCP* decision extends the relatively new, and stringent, *MFW* legal framework to directors of New York corporations. For those controllers willing to condition a buyout offer on a majority-of-the-minority vote, among other requirements, *KCP* and *MFW* provide a roadmap for obtaining meaningful protection from litigation risk.

If you have any questions concerning the material discussed in this client alert, please contact the following co-authors or any other members of our Mergers & Acquisitions practice group:

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[6] *Id*. at 16.