

Client Update

New York Adopts Delaware's *MFW* Standard for Going-Private Mergers

NEW YORK

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On May 5, 2016, the New York Court of Appeals, New York's highest court, adopted the standard of review promulgated by the Delaware Supreme Court in *Kahn v. M&F Worldwide Corp.* ("MFW")¹ for going-private mergers. Although this is the first instance of the highest court in a non-Delaware jurisdiction explicitly deciding to follow the Delaware *MFW* precedent, we believe it likely that courts in other states, when reviewing shareholder challenges to controlling shareholder transactions, will similarly be influenced by the approach taken by the Delaware courts.²

The New York decision involved the 2012 acquisition of the publicly traded shares of Kenneth Cole Productions, Inc. ("KCP") by its eponymous controlling shareholder. Kenneth Cole owned approximately 70% of the equity and 90% of the voting power of KCP. The remainder of the equity was publicly held and traded on the New York Stock Exchange. In February 2012, Cole proposed to acquire the minority shareholder interest in a going-private merger at a price of \$15.00 per share. His offer was conditioned on the approval of the transaction by a special committee of the board and by a majority of the unaffiliated shares. Cole told the board that he would not support an alternative transaction and that a decision by the special committee or the KCP minority shareholders to reject his proposal would not adversely affect his relationship with KCP.

After several months of negotiations, during which KCP apparently encountered some financial difficulties, the KCP special committee approved the transaction

¹ 88 A3d 635 (Del. 2014). The *MFW* decision is discussed in our client alert dated [March 14, 2014](#).

² We are not aware of any non-Delaware court that has explicitly declined to follow the approach set forth in *MFW* in the context of challenges to going-private transactions involving non-Delaware U.S. companies.

at a slightly increased price of \$15.25 per share. Over 99% of the unaffiliated KCP shares were voted in favor of the merger.

The inevitable shareholder litigation that followed the announcement of the transaction was dismissed, at both the trial and intermediate appellate court levels, for failure to state a claim, although each court followed a somewhat different path to this result. In appealing to New York's highest court, plaintiffs urged the court to subject the transaction to the test of entire fairness. Cole, on the other hand, asserted that the business judgment rule should apply. The Court of Appeals, in its May 5, 2016 decision, adopted a "middle ground," holding that the business judgment rule should apply so long as the protective provisions articulated by the Delaware Supreme Court in *MFW* were followed, and that entire fairness would apply if those conditions were not met.

In the *MFW* decision, the Delaware Supreme Court required the following six conditions to be met in order for a controlling shareholder buyout to be reviewed under the business judgment rule:

- the transaction must be conditioned at the outset on the approval of both a special committee and a majority of the minority shares;
- the special committee must consist solely of independent directors;
- the special committee must have the power to select its own advisors and to definitively reject the transaction;
- the special committee must meet its duty of care in negotiating a fair price;
- the vote of the minority stockholders must be fully informed; and
- the minority stockholder vote cannot be coerced.

The New York Court of Appeals held that this standard properly balances the rights of the minority shareholders against "the interests of directors and controlling shareholders in avoiding frivolous litigation and protecting independently-made business decisions from unwarranted judicial interference." Because the Court of Appeals found that the KCP plaintiffs did not sufficiently allege that any of the six *MFW* conditions had not been met, it applied the business judgment rule and upheld the dismissal of the complaint.

Over the past two years, most controlling shareholders pursuing going-private transactions involving Delaware companies have followed the *MFW* playbook. The New York Court of Appeals decision in KCP indicates that this approach is equally advisable in New York—and, likely, in other U.S. jurisdictions that have not yet had the occasion to consider challenges to going-private transactions

following the promulgation of the *MFW* decision—if the controller wishes to create the possibility of avoiding protracted litigation under the entire fairness standard.

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Please do not hesitate to contact us with any questions.