Matter of Kenneth Cole Productions, Inc.
2013 NY Slip Op 32114(U)
September 3, 2013
Sup Ct, New York County
Docket Number: 650571/2012
Judge: Lawrence Marks

SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: LAWRENCE K. MARKS Justice PART 41

In re Kenneth Cole Productions, Inc.
Shareholder Litigation

INDEX NO. 650571/2012

MOTION DATE

MOTION SEQ. NO. 005

MOTION CAL. NO.

The following papers, numbered 1 to ____ were read on this motion to/for ____

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☐ Yes ☐ No

Motion is decided in accordance with the attached decision and order.

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

Dated: 9-3-13

J.S.C.

Check one: ☑ FINAL DISPOSITION ☐ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST [ ] REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 41

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In re Kenneth Cole Productions, Inc. Shareholder Litigation

Index No. 650571/2012

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LAWRENCE K. MARKS, J.

Motions sequence 003, 004 and 005 are consolidated for disposition.

This is a class action arising from an effort by defendant Kenneth Cole ("Cole") to take defendant Kenneth Cole Productions, Inc. ("KCP" or "the Company") private. The gravamen of the complaint is that the price offered by Cole and approved by KCP's board of directors was unfair to the Company's minority shareholders.

In motion sequence 003, defendants Michael Blitzer ("Blitzer"), Paul Blum ("Blum"), Robert Grayson ("Grayson"), Denis Kelly ("Kelly"), Philip Peller ("Peller") and KCP move, pursuant to CPLR 3211 (a) (7), for failure to state a cause of action, for an order dismissing the complaint. In motion sequence 004, defendants Cole, KCP Holdco, Inc. ("Holdco") and KCP Mergerco, Inc. ("Mergerco") also move, pursuant to CPLR 3211 (a) (7), to dismiss the complaint. In motion sequence 005, defendant Marlin Equities VII, LLC ("Marlin") further moves, pursuant to CPLR 3211 (a) (7), to dismiss the complaint. For the reasons stated below, each of the motions is granted, and the complaint is dismissed as against each of the moving defendants.

BACKGROUND

According to the complaint, lead plaintiff Erie County Employees Retirement System is the owner of common stock of defendant KCP.

Defendant KCP is a New York corporation, which designs and markets a broad range of footwear, handbags and apparel under various brand names. Defendant Cole is the controlling shareholder of KCP and has served as its Chairman of the Board since its inception in 1982. As of February 24, 2012, Cole owned and/or controlled approximately 46% of the Company's outstanding common stock and 89% of the Company's voting power. Cole's voting power results from his ownership and control of 100% of the company's super-voting Class B common stock.

Defendant Blum is the Vice-Chairman of the Board and Chief Executive Officer of KCP, serving in those roles since 2011. Blum previously served under Cole as the Company's President from 2002 to 2006. According to plaintiffs, Blum is a Class B director, elected to the Board exclusively by Cole. Defendant Grayson has been a director of the Company since 1996. Grayson is a Class B director, who plaintiffs allege was elected to the Board exclusively by Cole. Kelly has been a director of the Company since 1994 and is also a Class B director, elected to the Board exclusively by Cole. Defendant Blitzer has been a director of the Company since 2009. Defendant Peller has been a director of the Company since 2005.

Defendant Marlin is an LLC controlled by Martin E. Franklin, a former director of the Company who resigned on December 31, 2011. Defendant Holdco is a Delaware corporation formed by Cole to facilitate the stock buyout at issue here. Defendant Mergerco is an indirect wholly owned subsidiary of Holdco.

On February 23, 2012, at a Board meeting, Cole proposed taking KCP private. He proposed a per share price of $15, and stated that he would not entertain any other offers to sell KCP. The $15 price represented a 17% premium over the sale price of the Company's stock on the previous day.

Cole's proposal was conditioned on the approval of a special committee of directors, which would be formed to consider the proposal, and the subsequent approval of a majority of the public shareholders. The Board immediately formed a special committee to consider the proposal and negotiate with Cole. The committee was comprised of four directors: defendants Blitzer, Grayson, Kelly and Peller. The proposal was made public the next day. The special committee considered the proposal and negotiated the price with Cole until June 6, 2012, when a merger agreement was announced. The parties settled on a price of $15.25 per share.

On June 29, 2012, KCP filed a "Preliminary Proxy Statement" with the Securities and Exchange Commission, which provided several rounds of comments. A proxy was filed with the SEC on August 24, 2012, and was distributed to the public shareholders for approval or rejection. On September 24, 2012, 99.8% of the shareholders, representing

more than eight million shares, voted to approve the transaction. Approximately 18,357 shares voted against the transaction.

The instant action follows the consolidation of several cases which were filed by minority shareholders after Cole first proposed to take the Company private.[1] The gravamen of the complaint stems from the contention that the special committee and Cole breached their fiduciary duties to the minority shareholders by negotiating a price which was unfair to those minority shareholders.

DISCUSSION

Motion Sequence 003:

In motion sequence 003, Blitzer, Blum, Grayson, Kelly, Peller and KCP move to dismiss the complaint under CPLR 3211(a) (7).

"A motion to dismiss under CPLR 3211 (a) (7) assumes the truth of the material allegations and whatever can be reasonably inferred therefrom and should be denied if, from the pleading's four corners, factual allegations are discerned which when taken together manifest any cause of action cognizable at law." *Le Bar Bat, Inc. v. Shallo*, 198 A.D.2d 49, 50 (1st Dep't 1993) (internal citation omitted). *See also Equis Corp. v. Mack-Cali Realty Corp.*, 6 A.D.3d 264 (1st Dep't 2004).

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[1] The parties entered into a stipulation to consolidate the related cases, as they "involve the same subject matter and the administration of justice would be best served by consolidating the actions." Stipulation dated June 27, 2012, and So Ordered July 9, 2012.

As a threshold matter, since none of the causes of action are against KCP, that portion of the motion that seeks its dismissal is granted.[2]

Plaintiffs' first cause of action is a breach of fiduciary duties claim against "all individual defendants."[3] Plaintiffs allege that the moving individual defendants, as directors and officers of KCP, have fiduciary relationships with plaintiffs and similarly situated public shareholders of KCP, and owe them the highest obligations of good faith, fair dealing, candor and loyalty. In the first cause of action, plaintiffs claim that these individual defendants breached their fiduciary duties by failing to safeguard the interests of the minority shareholders. Specifically, plaintiffs contend that the individual defendants negotiated the terms of the buyout in a manner that unfairly benefited Cole, to the detriment of the minority shareholders. They also assert that the individual defendants failed to make full material disclosures to the minority shareholders that would have enabled a fully informed shareholder vote on the buyout.

To state a claim for breach of fiduciary duty, plaintiffs must allege that (1) defendants owed them a fiduciary duty, (2) defendants committed misconduct, and (3) they suffered damages caused by that misconduct. *Burry v. Madison Park Owner LLC*, 84 A.D.3d 699, 699-700 (1st Dep't 2011). A cause of action for breach of fiduciary duty

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[2] Additionally, in light of the dismissal of the complaint as against the remaining defendants, KCP cannot be considered an indispensable party.

[3] This claim appears to relate to all individual defendants other than Cole, and a separate breach of fiduciary duty claim is brought against Cole as the second cause of action.

must also be pled with the requisite particularity of CPLR 3016 (b). *Berardi v. Berardi*, 2013 N.Y. App. Div. LEXIS 4888, *2-*3 (1st Dep't July 2, 2013). *See also Peacock v. Herald Sq. Loft Corp.*, 67 A.D.3d 442, 442-43 (1st Dep't 2009).

The complaint contains allegations that these individual defendants breached their duties because, although none of these defendants was financially interested in the stock purchase, they were not independent and were, instead, controlled by Cole. Specifically, plaintiffs contend that defendants Grayson and Kelly lacked independence because they were elected to the board by Cole. However, plaintiffs point to no authority for the assertion that a director lacks independence solely on the ground that he or she is elected by a controlling shareholder. The complaint also fails to set forth facts demonstrating a lack of independence on the part of any of the other individual defendants.

Plaintiffs also allege that defendants breached their duties by failing to solicit third-party bids. However, the complaint itself acknowledges Cole's consistent assertion, on several occasions, that he would reject any such offers. Moreover, it is undisputed that no such offers were received, despite the publicity surrounding Cole's attempt to repurchase the stock. Thus, the complaint does not adequately allege any facts that, if true, demonstrate that the decision not to seek other bids constituted a breach of fiduciary duty.

Plaintiffs further contend that defendants breached their duties by failing to get the highest possible price for the minority shareholders. Defendants argue that their actions

are protected by the business judgment rule. "As a general matter, courts are prohibited from inquiring into the propriety of actions taken by a director on behalf of the corporation." *Weinreb v. 37 Apts. Corp.*, 97 A.D.3d 54, 57 (1st Dep't 2012). The business judgment rule "prohibits judicial inquiry into the actions of corporate directors taken in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes." *Fletcher v. Dakota, Inc.*, 99 A.D.3d 43, 48 (1st Dep't 2012) (internal citations omitted).[4]

In the instant action, plaintiffs have failed to allege particularized facts sufficient to support a cause of action for breach of fiduciary duty in connection with the sale price. Plaintiffs' core claim is that they believe a higher price could have been obtained by the special committee. This assertion is based on comments from outside analysts and plaintiffs' own speculation about the company's financial prospects. However, plaintiffs acknowledge that the special committee negotiated with Cole over a period of months and obtained an increase in the price he would pay, from $15 to $15.25, where the original price represented a premium over the stock's most recent selling price.

Moreover, 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,

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[4] The rule does not apply to directors who engage in fraud or self-dealing or when they make decisions affected by an inherent conflict of interest. *Wolf v. Rand*, 258 A.D.2d 401, 404 (1st Dep't 1999). In such cases, the burden shifts to the defendant to prove the fairness of the transaction. *Id.*

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, and plaintiffs have not alleged any particular facts to support their view.

Importantly, 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. Plaintiffs have not even alleged facts that, if true, would give the Court a legitimate basis for judicial inquiry. Absent that, the Court is bound by the business judgment rule.

Plaintiffs allege that the proxy statement was misleading. However, plaintiffs do not allege any specific facts in support of this allegation. Thus, they fail to state a claim based on the proxy statement.

Finally, although not dispositive of the issue, the Court notes that 99.8% of the minority shareholders approved the buyout terms.

As such, plaintiffs have failed to state a cause of action against KCP, Blitzer, Blum, Grayson, Kelly and Peller, and this motion, which seeks dismissal of the first cause of action against them, pursuant to CPLR 3211 (a) (7), is granted.

Motion Sequence 004:

In motion sequence 004, Cole, Holdco and Mergerco move to dismiss the second and third causes of action in the complaint, in which plaintiffs assert claims for breach of fiduciary duty and aiding and abetting a breach of fiduciary duty.

Breach of Fiduciary Duty

The second cause of action in the complaint is for breach of fiduciary duty against Cole. The complaint contains allegations that, as the controlling shareholder of KCP, Cole had a duty "to provide good and prudent management, which demands that his decisions be made for the welfare, advantage, and best interests of the Company and the shareholders as a whole, not just for his own self-interest." Compl, ¶ 114. Plaintiffs also aver that Cole had fiduciary duties as a director and executive of the Company. Plaintiffs allege that Cole breached these obligations "by orchestrating a self-interested transaction and severely curtailed the Board's ability to negotiate the buyout on terms that are fair to the Company's minority shareholders." *Id.* at ¶ 116.

Majority shareholders have a "duty to provide good and prudent management, which demands that decisions be made for the welfare, advantage, and best interests of the corporation and the shareholders as a whole." *Alpert v. 28 Williams St. Corp.*, 63 N.Y.2d 557, 572 (1984). The complaint in the instant action contains sufficient allegations, for the purposes of this motion, that Cole, as the majority shareholder and as a participant in the company's management, had a duty of trust toward the minority

shareholders. However, the complaint does not contain adequate statements regarding a breach by Cole of that duty.

Plaintiffs allege that Cole acted in his own self-interest in negotiating the buyout. However, plaintiffs have failed to put forth any cases demonstrating that a controlling shareholder is prohibited from acting in his own economic interest, as long as his actions do not constitute unfair self dealing. Indeed, the Court of Appeals has held the precise opposite of plaintiffs' contention. The Court of Appeals held that, although minority shareholders are entitled to protection from abuse by controlling shareholders, minority shareholders "are not entitled . . . to inhibit the legitimate interests of the other stockholders." *Zetlin v. Hanson Holdings*, 48 N.Y.2d 684, 685 (1979).

Plaintiffs' main argument is that Cole acted unfairly by publicly stating that he would not participate in any third-party transactions; that is, that he would not agree to sell his stock in any such proposed deal. Plaintiffs contend that this announcement undermined the special committee's bargaining power against Cole, and significantly curtailed the special committee's ability to seek out other possible sales of the Company's stock which could have brought a higher price. Plaintiffs' argument is unpersuasive.

Plaintiffs put forth no law which suggests that a controlling shareholder, such as Cole, was required to acquiesce to any proposed third-party transactions. In fact, the ability to resist such a transaction would appear to be one of the benefits of having a controlling position in the company. Plaintiffs have also not demonstrated that Cole acted

improperly by negotiating as low a price as possible for the buyout. As noted above, plaintiffs proffer no case law to demonstrate that Cole was required to subvert his own economic interest, in obtaining a low price, to the minority shareholders' interest in obtaining a higher price.

As such, plaintiffs have failed to state a cause of action against Cole, and that portion of this motion that seeks dismissal of the second cause of action against him, pursuant to CPLR 3211 (a) (7), is granted.

Aiding and Abetting

Plaintiffs' third cause of action alleges that defendants Holdco and Mergerco (and defendant Marlin, which moved separately) aided and abetted Cole and the individual defendants in breach of their fiduciary duties to the minority shareholders. This cause of action contains assertions that, as participants in the buyout transaction, Holdco and Mergerco were aware of the breaches of fiduciary duties by Cole and the individual defendants. Plaintiffs claim that they actively and knowingly encouraged and participated in those breaches in order to obtain substantial benefits in the buyout to the detriment of the minority shareholders.

To state a claim for aiding and abetting, plaintiffs "must plead a breach of fiduciary duty, that the defendant knowingly induced or participated in the breach, and damages resulting therefrom." *Bullmore v. Ernst & Young Cayman Is.*, 45 A.D.3d 461, 464 (1st Dep't 2007) (internal citations omitted). A party "knowingly participates in a

breach of fiduciary duty only when [that party] provides substantial assistance to the primary violator." *Id.* (internal citations omitted). "Actual knowledge, as opposed to merely constructive knowledge, is required and a plaintiff may not merely rely on conclusory and sparse allegations that the aider or abettor knew or should have known about the primary breach of fiduciary duty." *Id.* (internal citations omitted). Moreover, a claim for aiding and abetting must be pled with particularity under CPLR 3016 (b). *Shearson Lehman Bros. Inc. v. Bagley*, 205 A.D.2d 467, 467 (1st Dep't 1994).

The complaint fails to state a claim against Holdco or Mergerco for aiding and abetting a breach of fiduciary duty. First, the alleged underlying breaches of fiduciary duty, asserted against the individual defendants in the first cause of action and Cole in the second cause of action, were insufficiently pled, as addressed above. Without the underlying breach of fiduciary duty, an allegation of aiding and abetting that breach cannot stand.

However, even if the underlying breach of fiduciary claims were not already dismissed, this claim against Holdco and Mergerco would not survive their motion to dismiss. With respect to the individual defendants, the complaint does not contain allegations of any facts demonstrating any connection between the individual defendants and either Holdco or Mergerco, to support a claim for aiding and abetting. With respect to Cole, plaintiffs assert, in a conclusory manner, that both entities were formed by Cole for the purpose of conducting the buyout and that both entities should be considered his

alter egos. Plaintiffs, therefore, argue that the entities are liable for aiding and abetting him in breaching his fiduciary duties. However, even if the complaint contained a sustainable claim against Cole for breach of fiduciary duty, the complaint does not include particular facts, as required by CPLR 3016 (b), to demonstrate actual knowledge of a breach and substantial assistance in such breach on the part of either Holdco or Mergerco. Such knowledge is required to sustain a cause of action of aiding and abetting breach of fiduciary duty. Allegations of constructive knowledge, or that defendant was on notice as to the tortious behavior of the wrongdoer, are not legally sufficient to sustain a cause of action. *Kaufman v. Cohen*, 307 A.D.2d 113, 125 (1st Dep't 2003). Nor are "conclusory allegations" regarding alter ego status sufficient to sustain an action. *Brainstorms Internet Mktg. v. USA Networks, Inc.*, 6 A.D.3d 318, 318 (1st Dep't 2004). *See also Global Mins. & Metals Corp. v. Holme*, 35 A.D.3d 93, 101-02 (1st Dep't 2006).

Accordingly, plaintiffs have failed to state a cause of action against Holdco and Mergerco, and that portion of this motion that seeks dismissal of the third cause of action against them, pursuant to CPLR 3211 (a) (7), is granted.

Motion Sequence 005:

Marlin also, and separately, moves to dismiss the third cause of action in the complaint, which asserts a claim for aiding and abetting breach of fiduciary duty. As with Holdco and Mergerco, the complaint only contains allegations that Marlin, as a

participant in the buyout transaction, was aware of the breaches of fiduciary duties by the individual defendants and Cole and actively participated in such breaches in order to obtain substantial benefits in the buyout to the detriment of the Company's minority stockholders.

Plaintiffs have failed to state a cause of action for aiding and abetting a breach of fiduciary duty. First, as set forth above, plaintiffs have not adequately stated a claim for the required underlying breach of fiduciary duty against the individual defendants and Cole. Without this, a claim for aiding and abetting that breach of fiduciary duty must fail.

Additionally, the allegations against Marlin are conclusory. The complaint does not set forth any specific alleged actions, by Marlin, that would support this cause of action. Indeed, the complaint does not mention Marlin in any of the substantive allegations.

Plaintiffs merely allege that Marlin is controlled by Martin Franklin, a former director of KCP, who resigned from the Company in December 2011. Plaintiffs assert that Cole consulted with Franklin before the buyout, and was assisted financially by Marlin in consummating the deal. Plaintiffs argue that the Court should infer that Franklin, as a former insider of KCP, knew that Cole was offering an unfair price in the transaction and, thus, aided in the breach of fiduciary duty. Plaintiffs' arguments are unpersuasive.

The complaint does not set forth any facts that, if true, would establish that Marlin, or Franklin, had actual knowledge of a breach of duty by Cole and substantially assisted in that breach. *Bullmore v. Ernst & Young Cayman Islands*, 45 A.D.3d at 464. *See also Kaufman v. Cohen*, 307 A.D.2d 113, 125-26 (1st Dep't 2003). At most, the complaint demonstrates that Marlin, through Franklin, helped Cole to orchestrate the transaction. It does not demonstrate aiding or abetting a breach of fiduciary duty with the specificity required under CPLR 3016 (b).

Accordingly, plaintiffs have failed to state a cause of action against Marlin and this motion, which seeks dismissal of the third cause of action against it, pursuant to CPLR 3211 (a) (7), is granted.

The Court has considered the parties' other arguments, and finds them unavailing.

Accordingly, it is

ORDERED that motion sequence 003, by defendants Michael Blitzer, Paul Blum, Robert Grayson, Denis Kelly, Philip Peller, and Kenneth Cole Productions, Inc., to dismiss the complaint is granted and the complaint is dismissed as to those movants; and it is further

ORDERED that motion sequence 004, by defendants Kenneth Cole, KCP Holdco, Inc. and KCP Mergerco, Inc., to dismiss the complaint is granted and the complaint is dismissed as to those movants; and it is further

ORDERED that motion sequence 005, by defendant Marlin Equities VII, LLC, to dismiss the complaint is granted and the complaint is dismissed as to that movant.

This constitutes the Decision and Order of the Court.

Dated: September 3, 2013

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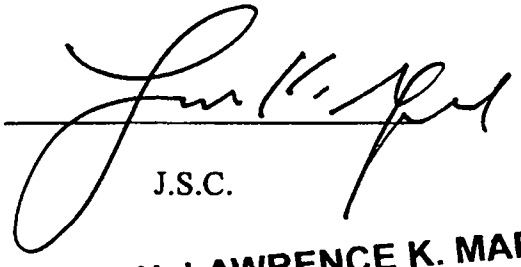

J.S.C.

HON. LAWRENCE K. MARKS