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COURT OF APPEALS

STATE OF NEW YORK

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MATTER OF KENNETH COLE PRODUCTIONS, INC.,  
SHAREHOLDER DERIVATIVE LITIGATION

Respondent.

No. 54

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20 Eagle Street  
Albany, New York 12207  
March 23, 2016

Before:

ASSOCIATE JUDGE EUGENE F. PIGOTT, JR.  
ASSOCIATE JUDGE JENNY RIVERA  
ASSOCIATE JUDGE SHEILA ABDUS-SALAAM  
ASSOCIATE JUDGE LESLIE E. STEIN  
ASSOCIATE JUDGE EUGENE M. FAHEY  
ASSOCIATE JUDGE MICHAEL J. GARCIA

Appearances:

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Meir Sabbah  
Official Court Transcriber

1 JUDGE PIGOTT: Matter of Kenneth Cole.

2 Mr. Rudy.

3 MR. RUDY: Thank you, Your Honor.

4 Lee Rudy for the Erie County Employees  
5 Retirement System. I'd like to reserve two minutes for  
6 rebuttal, if I could.

7 JUDGE PIGOTT: That's fine, yup.

8 MR. RUDY: Thank you.

9 This appeal concerns the standard of review for  
10 controlling stockholder freeze-out transactions where  
11 minority stockholders are vulnerable to abuse. Alpert  
12 listed three types of freeze-out transactions including  
13 going-private transactions, and said that in freeze-outs,  
14 a controlling stockholder has to prove that the  
15 transaction is entirely fair.

16 JUDGE ABDUS-SALAAM: But this isn't exactly  
17 the type of freeze-out that was involved in Alpert,  
18 even though Alpert did mention two other types of  
19 freeze-outs, but the one that was involved in Alpert  
20 was a two-step freeze-out, with no input from the  
21 minority shareholders about whether they would be  
22 cashed out. And this is slightly different, so why  
23 wouldn't it require a different standard than the  
24 Alpert standard?

25 MR. RUDY: Okay. Well, first of all, it's

1 clear that yes, the facts are different and that that  
2 was a two-step transaction. If you read the words of  
3 Alpert, which I think are fairly clear, it says, any  
4 freeze-out transaction, this is the standard that  
5 applies. And it doesn't - - - it doesn't say, this  
6 is the standard that applies to a two-step merger.  
7 There is reason to believe that the arm's length  
8 negotiation between the defendants in Alpert and the  
9 prior owners of that corporation were a true arm's  
10 length negotiation.

11 The language of the decision actually says,  
12 we are setting a standard for freeze-out  
13 transactions. I can read it, "In reviewing a freeze-  
14 out merger, the inquiry is to determine whether the  
15 transaction was fair to all concerned." And then it  
16 lists the three types of freeze-outs. So yes, this  
17 case is different, and yes, there are different  
18 protections in this case that I can get to, but there  
19 is no reason to think that a different standard of  
20 review would apply.

21 I think what the court is saying is that  
22 there is a standard of review that applies where  
23 these dangerous, potentially abusive transactions  
24 occur, and we're going to look at them under this  
25 strict scrutiny.



1 outside of the entire fairness analysis, then you're  
2 basically saying there is no scrutiny that is going  
3 to apply at all to this - - -

4 JUDGE PIGOTT: Well, I read Alpert to  
5 suggests some of the things that was done here. You  
6 know, an independent committee, a neutral look at the  
7 thing, which is what it looks like they did here.

8 MR. RUDY: They did - - - they did have a  
9 special committee, and they did have a majority-  
10 minority vote. But I think the question is, does  
11 that - - - do those facts alone cause us to abandon  
12 the standard that was set in Alpert, which is a  
13 flexible standard and can be applied to all different  
14 types of - - -

15 JUDGE STEIN: But the MFW standard doesn't  
16 just accept that those two things exist; it goes  
17 further. It goes behind those two things and says  
18 well, first of all, we want to make sure that they  
19 are genuine, and that they are really independent,  
20 and that they're really doing what they are intended  
21 to do. And only then do we get to the business  
22 judgment rule. So - - -

23 MR. RUDY: That's right, so - - -

24 JUDGE STEIN: - - - isn't - - - I mean, I  
25 guess my question is, is that really that much

1 different from what you say the rule established in  
2 Alpert was?

3 MR. RUDY: It - - - it's - - - yes, it is  
4 different. I mean - - -

5 JUDGE STEIN: How - - - how is it - - - how  
6 is it different?

7 MR. RUDY: Well, first of all, you - - - if  
8 you have an entire fairness standard that can be  
9 gutted by - - - or can be - - - can be avoided by the  
10 - - -

11 JUDGE STEIN: But it's not being avoided,  
12 it's saying it's meeting that standard. And once you  
13 establish that it's met that standard, then we're  
14 going to fall back to the - - -

15 MR. RUDY: It dep - - -

16 JUDGE STEIN: - - - business judgment rule;  
17 that's how I kind of see it.

18 MR. RUDY: It depends, I mean, that's not  
19 what the defendants are actually asking for. The  
20 defendants are saying that it was appropriate to  
21 dismiss this case with no discovery. Under MFW, you  
22 would have - - -

23 JUDGE STEIN: Well, that's a different  
24 question.

25 MR. RUDY: Right. Okay.

1 JUDGE STEIN: Yeah.

2 MR. RUDY: So you're asking me if we - - -

3 JUDGE STEIN: I'm just talking about the  
4 standard.

5 MR. RUDY: - - - you adopted MFW. So if  
6 you adopted MFW, there would be discovery into  
7 whether the special committee functioned  
8 appropriately. I think our complaint gives good  
9 reason to think that this is not a properly  
10 functioning special committee. But I think the  
11 reason that I'm urging this court to rely on Alpert  
12 and stick to the standard that you've had for several  
13 decades is that these provisions, special committees,  
14 and majority-minority votes, are deeply flawed and  
15 have been proven to be deeply flawed in certain  
16 circumstances.

17 They can work - - -

18 JUDGE PIGOTT: Well, they make the point -  
19 - - quoting from part of their brief, they say, "The  
20 minority shareholders here were not forced to sell  
21 their shares as the merger plan did in Alpert, and  
22 did not" - - - "and indeed, if the minority  
23 shareholders want to keep their shares, and prevent  
24 Cole from taking the company private, all they would  
25 have to do is vote against it." Is that true?

1 MR. RUDY: If - - - if the minority  
2 stockholders had voted this transaction down by their  
3 vote, then they would remain captive in a company  
4 with a controlling stockholder who doesn't want them  
5 there.

6 JUDGE PIGOTT: No, they would - - - but  
7 they could keep their shares and do what they were  
8 doing yesterday. I mean - - -

9 MR. RUDY: Yes. They wou - - - and they -  
10 - - and that's the reason that there's decisions like  
11 Citron and other decisions that talk about the  
12 coercion and of these votes and why minority - - -  
13 majority-minority votes are not an adequate  
14 protection. Because stockholders look at these  
15 situations and they say, do I want to stay a  
16 stockholder of Kenneth Cole anymore, when he is  
17 trying to squeeze me out.

18 JUDGE PIGOTT: Well, I looked at - - - as  
19 Judge Stein was raising, the Delaware case; what more  
20 do you think they should have done? Are you accusing  
21 the board of collusion, are you saying that the  
22 committee was fraudulent; what - - - what - - -

23 MR. RUDY: What more should the committee  
24 had done?

25 JUDGE PIGOTT: I'm - - - I'm looking for

1           what - - - I mean, I look at it from the point of  
2           view of somebody that says, I'm take - - - I want to  
3           take my company private and I'm doing all of this  
4           stuff. And you're saying that's not enough.

5                     MR. RUDY: Well, I am not saying - - - yes,  
6           I'm saying it's not enough, but to be - - -

7                     JUDGE RIVERA: The real question, if I may,  
8           is what more would have protected the minority  
9           shareholders.

10                    MR. RUDY: In the facts of the case as  
11           we've pled based on - - -

12                    JUDGE RIVERA: Correct.

13                    MR. RUDY: Well, first of all, I'm pleading  
14           based on public information. So what more would  
15           happen is you would have a court that looks at it to  
16           determine whether the transaction is actually fair,  
17           which is what happened in Alpert. After there was  
18           found to be a fair process, the court - - -

19                    JUDGE STEIN: What would we look at?

20                    MR. RUDY: What factors - - -

21                    JUDGE STEIN: What would we look at or a  
22           court look at to make that determination?

23                    MR. RUDY: Well, you would look it - - -  
24           you would look it, among other things, the things  
25           that you identified in MFW, you would look it to see

1           whether - - - was this a properly functioning special  
2           committee or was this a committee like in Southern  
3           Peru that rolled over and gave the controller what it  
4           wanted.

5                         JUDGE RIVERA: That - - - doesn't it really  
6           boil down to looking at whether or not the choice at  
7           the end is correct?

8                         MR. RUDY: The choice to - - -

9                         JUDGE RIVERA: The decision whether or not  
10          to allow Kenneth Cole to be able to buy the shares at  
11          a particular right - - - price.

12                        MR. RUDY: Well, Kenneth Cole is allowed -  
13          - -

14                        JUDGE RIVERA: Isn't that what it really  
15          boils down to?

16                        MR. RUDY: I'm not sure - - - what today, I  
17          think it boils down to is what standard of review  
18          applies to that transaction. So the question is does  
19          the court defer if the plaintiff says this looks  
20          unfair, and the court says, well, but there are these  
21          provisions and it appears that they were done  
22          properly, so we're going to defer to those  
23          provisions? Or does the court actually look to see  
24          whether it's fair in price and in process; that's  
25          what I think it boils down to.

1 JUDGE FAHEY: Well, let's say - - -

2 JUDGE RIVERA: But that's what I'm saying,  
3 when you say in price, at the end of the day, isn't  
4 this this disagreement - - -

5 MR. RUDY: Right.

6 JUDGE RIVERA: - - - about the buyout  
7 price - - -

8 MR. RUDY: Yes, and I think it's important  
9 to note that - - - that even - - -

10 JUDGE RIVERA: - - - but it was not enough  
11 and so therefore, it's not fair.

12 MR. RUDY: Well, yes. It's ultimately  
13 about price. The remedy we're seeking here is more  
14 money for the stockholders.

15 JUDGE RIVERA: Uh-huh.

16 MR. RUDY: So that's what we think we  
17 deserve in this case. And I think it's important - -  
18 -

19 JUDGE ABDUS-SALAAM: So at 16.50 you would  
20 have - - - at 16.50 - - -

21 MR. RUDY: Sorry?

22 JUDGE ABDUS-SALAAM: If the stock had sold  
23 to Cole at 16.50, we wouldn't be here, is what you're  
24 saying?

25 MR. RUDY: I don't know if that particular

1 number is correct, but yes. If the price had been  
2 higher and we had been able to verify that that was a  
3 fair price for our clients and for the class, then we  
4 would have - - - we would not be here suing over it.

5 JUDGE FAHEY: I didn't think you were  
6 talking about a number; I thought you were saying if  
7 there had been any other bid solicited at all. I  
8 thought that's was - - - was the path you were  
9 taking.

10 MR. RUDY: Well, the relevance of the  
11 alternative bids, I think the trial court maybe  
12 misunderstood what the complaint was about on this.

13 JUDGE FAHEY: Uh-huh.

14 MR. RUDY: The special committee has the  
15 obligation to figure out whether it's negotiating in  
16 good faith with the controller, and one of the ways  
17 that courts say you should do that is by testing the  
18 market.

19 So even though Mr. Cole said, I don't want to  
20 sell to anybody else, the special committee should have  
21 gone out and said, what could we sell Kenneth Cole for,  
22 and then gone back to Cole and said, look buddy, you're  
23 offering me fifteen dollars; we could sell this company  
24 for eighteen right now.

25 JUDGE FAHEY: Right. I want to take you to

1           one step - - - let's assume that this court adopts  
2           the MFW standard, and so we are going through the  
3           five factors there. How does your compl - - - does  
4           your complaint - - - and that's really all we're  
5           talking about now - - - does your complaint survive  
6           if we apply that standard?

7                         MR. RUDY: Well, absolutely, yes.

8                         JUDGE FAHEY: How so?

9                         MR. RUDY: Well, first of all, I mean, MFW  
10           specifically says that the pleading standard is a  
11           reasonable concei - - - reasonably conceivable set of  
12           facts to cast doubt on any of the MFW factors.

13                        JUDGE FAHEY: Uh-huh.

14                        MR. RUDY: I think our complaint more than  
15           adequately casts doubt on whether the special  
16           committee actually negotiated at arm's length  
17           vigorously with Mr. Cole, as he was supposed to. The  
18           special committee never made a counteroffer, never  
19           checked the market, downwardly adjusted the  
20           projections it was using during the middle of its  
21           negotiations. These were people that had long - - -  
22           decades-plus long ties where they - - -

23                        JUDGE ABDUS-SALAAM: I thought the - - -  
24           I'm sorry, counsel, when you said that the committee  
25           never made a counteroffer, I thought that the final

1 price was a result of a counteroffer that the  
2 committee made.

3 MR. RUDY: No, it was the result of them  
4 saying, we need you to please improve your price,  
5 which is very different from a counteroffer. Please  
6 improve your price is, I know you're offering  
7 fifteen, could you make it a little bit more. It is  
8 not, we'll do it for twenty.

9 JUDGE ABDUS-SALAAM: When he offered  
10 sixteen, didn't they come back with 16.50?

11 MR. RUDY: When they said 16, he s - - -  
12 they said 16.50, he then abandoned 16, and they said,  
13 please improve 15 to something, and they took 15.25.

14 So, I mean, it's not - - - there is good reason  
15 on the face of the complaint.

16 JUDGE FAHEY: What would you have liked to  
17 have seen instead of that?

18 MR. RUDY: To have seen instead of that?

19 JUDGE PIGOTT: Yeah.

20 MR. RUDY: Well, I think I've said that  
21 they should have market tested the - - -

22 JUDGE PIGOTT: No, no, no, I mean, I get  
23 that. But, I mean, we're sitting here - - - you said  
24 we'll take 16.50, how can we trust you; how can we  
25 trust anybody that says any number unless we want to

1 say in every single buyout, we're going to have a  
2 hearing, we're going to have a trial, and we're going  
3 to have a - - - you know, three or four years of  
4 litigation - - -

5 MR. RUDY: Well - - -

6 JUDGE PIGOTT: - - - over what looks like,  
7 you know, what should have happened, happened.  
8 Somebody overshoot on their demand, and ended up with  
9 a little less.

10 MR. RUDY: Well, Your Honor, to be fair,  
11 the negotiation between the special committee and Mr.  
12 Cole was not - - - that's an arm - - - it's a  
13 simulated negotiation.

14 JUDGE PIGOTT: You say that, but you're the  
15 one that said you'd take 16.50.

16 MR. RUDY: I said that? I didn't say - - -

17 JUDGE PIGOTT: You personally said that.  
18 When we we're just - - -

19 MR. RUDY: I didn't say that.

20 JUDGE PIGOTT: Judge Abdus-Salaam said, so  
21 at 16.50 you wouldn't be here. And you said, yes.

22 MR. RUDY: I said I don't know about that  
23 price; I said that at a certain price, that's true.

24 JUDGE PIGOTT: Then I misunderstood.

25 MR. RUDY: I apologize if that was what it

1           sounded like.

2                   JUDGE PIGOTT:  It's probably my mistake.

3                   MR. RUDY:  I said the opposite of that.

4                   Your Honor, I think if I could just - - - MFW -  
5           - - you're asking if MFW was the standard, and I really  
6           think that there is good reasons that MFW should not be  
7           adopted as the standard here.  And I see I have a red  
8           light, I'd like to just - - -

9                   JUDGE PIGOTT:  Please continue, please.

10                  MR. RUDY:  - - - give that answer, if I  
11           could.

12                  You know, MF - - - first of all, I think  
13           Alpert works.  Al - - - there has been no complaint  
14           on a policy matter that any defendant has said, I'd  
15           love to do a deal to cash out minority stockholders -  
16           - -

17                  JUDGE STEIN:  Has Alpert ever been applied  
18           in this kind of transaction?

19                  MR. RUDY:  That there is a reported  
20           decision on?

21                  JUDGE STEIN:  Yes.

22                  MR. RUDY:  No.  Not that I know.  There has  
23           also never been a New York decision that throws out a  
24           controlling stockholder case on the pleadings, and  
25           never been a New York case that applies business

1 judgment to a conflicted transaction.

2 I mean, there is Chelrob and Limmer, and a  
3 lot of other cases where conflicted fiduciaries have  
4 to come forward and establish the fairness of their  
5 transactions.

6 But, just getting to the why you should not  
7 adopt MFW. First of all, you have a workable  
8 standard. Second of all, it's bad policy. It's just  
9 - - - there is no support. I know the Del - - - I  
10 have tremendous respect for the Delaware Supreme  
11 Court, but there is no policy - - - you have plenty  
12 of decisions, both social science decisions and legal  
13 decisions, that show that special committees often  
14 fail to negotiate good deals with controlling  
15 stockholders; they roll - - - roll over, like  
16 Southern Peru. They fail because they're defrauded,  
17 like in Dole.

18 And then minority votes, there is good  
19 literature, both - - - and good social science that  
20 show those votes are not adequate protection for  
21 stockholders.

22 JUDGE PIGOTT: Thank you.

23 MR. RUDY: And so, finally, on the Delaware  
24 standard, Delaware has a very different statutory  
25 regime. And it's important to understand that New

1 York, that does not have appraisal rights - - -  
2 appraisal rights show up in the Alpert decision  
3 because they used to have appraisal rights, but there  
4 are no appraisal rights for stockholders here. So if  
5 - - - if this action, or if this type of action  
6 cannot proceed, this is the - - - this is the end of  
7 the road for stockholders. They can't petition for a  
8 fair price. They either have a class action such as  
9 this, or a direct action, or they are banned from  
10 getting any remedy at all.

11 JUDGE PIGOTT: Thank you, Mr. Rudy. You  
12 have your - - - you have your rebuttal time.

13 MR. RUDY: Thank you.

14 JUDGE PIGOTT: Mr. Mundiya, am I  
15 pronouncing your name correctly?

16 MR. MUNDIYA: You are, Your Honor.

17 Good afternoon.

18 Eight minutes for Mr. Cole, and Mr. Stern will  
19 speak for four minutes for the special committee.

20 Good afternoon. I represent Kenneth Cole, KCP  
21 MergerCo, and KCP HoldCo.

22 This is a post-merger stockholder class action  
23 challenge to a going-private transaction in which 99.8  
24 percent of the stockholders who voted, voted in favor of a  
25 transaction. A transaction - - -

1                   JUDGE GARCIA: Can - - - I'm sorry to  
2 interrupt you, but what about this idea that the  
3 special committee maybe isn't so special, right, that  
4 is, under the sway of management of the company.

5                   MR. RUDY: Well, Judge Garcia, we have four  
6 special committee members. The fact that two of them  
7 were elected, or Mr. Cole voted in favor of those two  
8 - - - those two directors, and the fact that the  
9 other two directors were elected by the public  
10 stockholders, does not make them controlled directors  
11 or the - - - under the domination or control of Mr.  
12 Cole. That's hornbook law, that's Delaware law,  
13 that's New York law.

14                  JUDGE GARCIA: Accept that, but what about  
15 the reality of the boardroom, right, and you have  
16 directors, you have management, you have management  
17 like this, certainly strong majority shareholder; how  
18 can we be sure that that is not influencing your  
19 independent directors?

20                  MR. MUNDIYA: If that were the standard,  
21 then any corporation with a controlling stockholder  
22 would not be able to have a majority of independent  
23 directors. These directors had the power to say no.  
24 They engaged outside financial advice.

25                  JUDGE GARCIA: That also may be the reason

1 we apply an entire fairness standard, right?

2 MR. MUNDIYA: Right. But they also had the  
3 power to say no to Mr. Cole, and as a Justice Abdus-  
4 Salaam pointed out, there was a negotiation here.  
5 There was a negotiation of a three-and-a-half to four  
6 months, they hired independent investment bankers to  
7 negotiate with Mr. Cole, the disclosures about price  
8 - - - Mr. Rudy talked about price - - - the  
9 disclosures in this proxy statement were amongst most  
10 incredible fulsome disclosures that I've seen in a  
11 proxy statement.

12 We had the projections from March 2012,  
13 projections from May 2012, budgets, the fairness  
14 opinion by the investment bankers; it was all there  
15 and these directors hired the independent bankers to  
16 negotiate with Mr. Cole.

17 So - - - and Mr. Cole didn't have to do that.  
18 He didn't have to give this discretion to the independent  
19 committee; he chose to do that. He chose to take this out  
20 of Alpert, he chose to give the stockholders a vote - - -  
21 and up-or-down vote, and he's made it clear in his  
22 February 2012 letter, he made it absolutely clear: If  
23 these conditions are not met, this company will remain  
24 public.

25 JUDGE STEIN: Well, would you agree,

1           though, that if on their face, these conditions were  
2           set up, but that in fact the process that the  
3           committee went through and the price that was reached  
4           was not by any means fair, that they should be  
5           subject to some oversight?

6                       MR. MUNDIYA: Well, yes, Judge Stein, the  
7           six factors in MFW, to go back to Judge Fahey's  
8           question, if those conditions were not met, to be  
9           sure, the complaint should go forward. But this  
10          complaint is devoid, is conclusory, and it basically  
11          says, you know, I think you guys could have done  
12          better, and that - - - and they were pushed on that  
13          very point, both before Justice Marks, and by the  
14          Appellate Division.

15                      They asked same questions you have asked;  
16          what should they have done. What could have been  
17          done better? And all they could come up with today  
18          and in the courts below was, we think they should  
19          have gotten a better price, we think they should have  
20          created more leverage with the negotiations.

21                      JUDGE RIVERA: Well, they said they should  
22          have gone out and figured out whether or not someone  
23          else is interested, whether or not there was a better  
24          price, and come back and pushed harder. That sounds  
25          to me very different from, oh, they just kind of said

1 - - -

2 MR. MUNDIYA: Well - - -

3 JUDGE RIVERA: - - - you could have done a  
4 little bit better.

5 MR. MUNDIYA: Not necessarily, Your Honor.  
6 The law in Delaware and in New York is, a board of  
7 directors is under no obligation to engage in futile  
8 acts. It is hornbook law here in New York and in  
9 Delaware that a controlling stockholder who owns  
10 forty-five percent of the economics, ninety percent  
11 of the voting power, has the right to act in his or  
12 her own economic interest. And that's all Mr. Cole  
13 did.

14 In MFW, the stockholder there made it  
15 perfectly clear he was not a seller. And the court  
16 went forward and said, with those two protections,  
17 the business judgment rule applied. But to go back  
18 to those six factors - - - and they're critical  
19 because they are subsumed, we say, within the  
20 business judgment rule in New York - - - one, did the  
21 controller condition~~ed~~ the transaction on the  
22 approval of a special committee and a majority of the  
23 minority? Yes. Two, is a special committee  
24 independent? Yes. No allegation, well founded,  
25 particularized, as this court has held in Marx v.

1 Akers, Auerbach v. Bennett, there is no  
2 particularized allegation that these directors were  
3 beholden to Mr. Cole.

4 JUDGE STEIN: I think what - - - I think  
5 probably the - - - the factor that's most in question  
6 here probably be - - - would be whether the committee  
7 met its duty of care in negotiating fair price,  
8 right?

9 MR. MUNDIYA: Let - - - let me address that  
10 - - - let me address that, because under New York  
11 law, the standard of a duty of care is recklessness  
12 or gross negligence or bad faith or self-dealing.  
13 Those of the things that take this case out of the  
14 business judgment rule. And there is no  
15 particularized allegation that what these directors  
16 did, or for that matter what Mr. Cole did, amounted  
17 to bad faith. All Mr. Cole did was said - - - say,  
18 I'm not a seller, I'm a buyer.

19 But he did - - - he went further than that.  
20 He said, I will not force my will on these  
21 shareholders - - - see Alpert - - - unless I have  
22 these two protections. And if neither of those  
23 protections are met, this company will remain public.

24 JUDGE STEIN: But do you disagree that if  
25 sufficient allegations are made, or were made, that

1 the court would have the authority to look at the  
2 fairness of the process and the result?

3 MR. MUNDIYA: Well, certainly, if  
4 sufficient allegations were made, then there would be  
5 - - - there would have to be some process. As MFW  
6 has held, as post - - -

7 JUDGE STEIN: Yes, and MFW says - - -

8 MR. MUNDIYA: Exactly.

9 JUDGE STEIN: - - - when you get to go  
10 beyond the pleading stage, and - - -

11 MR. MUNDIYA: Right.

12 JUDGE STEIN: - - - when you get to go  
13 beyond the summary judgement stage. And - - - but  
14 you have - - - so you have no problem with that  
15 standard, you just think that it wasn't met here.

16 MR. MUNDIYA: It was - - - it wasn't even  
17 close to being met in this case. And they were  
18 pushed hard in the courts below and they couldn't  
19 come up with anything.

20 And if you look at the two cases that Mr.  
21 Rudy cited, Dole, where there was particularized  
22 allegations of bad faith, or in - - - in the other  
23 going-private transaction that Mr. Rudy mentioned,  
24 there were particularized allegations of bad faith or  
25 self-dealing. This is the antithesis of self-

1           dealing; this is a controlling stockholder who says,  
2           hands off; it replicates a third-party deal. This  
3           replicates a arm's length transaction.

4                       And under Delaware law and in New York law,  
5           when you have a third-party deal - - - see Kassoover,  
6           see Marx v. Aker, see Auerbach v. Bennett, decades of  
7           jurisprudence in this court say that is governed by  
8           the business judgment rule and there is nothing in  
9           this complaint, nothing in this complaint that takes  
10          this case out of the business judgment rule.

11                      JUDGE PIGOTT: Thank you, Mr. Mundiya.

12                      MR. MUNDIYA: Thank you.

13                      JUDGE PIGOTT: Mr. Stern.

14                      MR. STERN: Thank you, Your Honor.

15                      My clients were the four independent outside  
16          directors of Kenneth Cole Productions. With the court's  
17          permission, I would like to focus my time on three points  
18          in particular, in addition to any questions the court may  
19          have. And that is the pleading standard that applies  
20          here, as conceded by the plaintiffs and the appellants;  
21          the independence factor; and the failure of the appellants  
22          to allege that the overwhelming shareholder vote here was  
23          either coerced or uninformed.

24                      Now, my clients, Your Honors, were sued for  
25          breaching their fiduciary duties as directors, quite

1           literally before they had done anything whatsoever in  
2           connection with this transaction. All they had done was  
3           receive that offer, as directors, and they face class  
4           action lawsuits.

5                         JUDGE ABDUS-SALAAM: Did your clients have  
6           any concern that they might not be independent, based  
7           on actions done, or conduct that they engaged in  
8           before this transaction? For example, Mr. Cole  
9           allowing him to - - - the board taking on his jet for  
10          him, and allowing him to get involved in a business  
11          deal, or give his brother, you know, an exclusive on  
12          a trademark, or something.

13                        MR. STERN: Those allegations, Your Honor,  
14          in the complaint are so vague and thin as to make it  
15          very difficult to understand even what the plaintiffs  
16          were talking about. But the answer to your question  
17          is yes, the record reflects they considered from the  
18          outset who could be independent.

19                        Four of the directors out of the total on  
20          the board, which was at the time seven, I believe,  
21          were chosen as the independent special committee.  
22          The plaintiffs' allegations as to the independents,  
23          their attempts to rebut the business judgment rule by  
24          alleging a lack of independence, are almost  
25          invisible.

1 Under New York law, it is necessary to  
2 allege, and ultimately to prove, that the directors  
3 either were self-interested in the transaction or  
4 actually controlled in some way by the - - - by the  
5 controlling shareholder. Neither of those factors  
6 appears in the complaint aside from the innuendo that  
7 you refer to, Your Honor.

8 What the record actually reflects is that  
9 all four of these directors had interests that were  
10 precisely aligned with the public shareholders. They  
11 had no motivation to entrench themselves, which you  
12 see in some public company cases, because they were  
13 putting themselves out of a job. If the company went  
14 private, they would no longer be directors; and  
15 that's what happened. And each of them owned, what  
16 was to them, a significant number of the class A  
17 shares - - - the public shares. Roughly 180,000  
18 shares, two-and-a-half-million dollars' worth, real  
19 money, and they had exactly the same interest as the  
20 public shareholders in maximizing the value of those  
21 shares.

22 Going forward, if the merger were to occur,  
23 they would have no further interest in the company,  
24 just like the public shareholders. So they stood in  
25 exactly the same shoes as the public shareholders,

1 and were exactly the right types of representatives  
2 to be negotiating.

3 And the only reasonable inference from the  
4 complaints, allegations, and the public disclosures  
5 is that if the merger were not in the interest of the  
6 public shareholders, the special committee would have  
7 recommended against it, which of course they did not  
8 do.

9 It is blackletter law under New York law  
10 and under Delaware law that simply alleging that Mr.  
11 Cole's voting power, in the case of the two - - - two  
12 of the directors, was enough to put them on the  
13 board, is not enough.

14 And by the way, in the case of two of the  
15 directors, they were not - - - Mr. Cole's shares were  
16 sterilized. He didn't vote for them at all; they  
17 were voted entirely by the public shareholders. All  
18 four of the directors received more than eighty  
19 percent of the public's votes in the most recent  
20 election. That's - - -

21 JUDGE STEIN: So you're saying, once it's  
22 shown that they are independent, no further inquiry;  
23 it's business judgment rule?

24 MR. STERN: Once it's shown that they are  
25 independent and, Your Honor, as Mr. Mundiya was

1 discussing, as long as the plaintiffs haven't alleged  
2 a specific basis for undermining those MFW factors,  
3 then business judgment rule should apply.

4 We are not saying that there is no inquiry if  
5 those factors can be challenged. The point, Your Honor,  
6 is that in this case, they have not been. In this case,  
7 the plaintiffs had put boilerplate allegations, they seek  
8 to ignore the vote of 99.8 percent of the public  
9 shareholders - - - it's a staggering number, 99.8 percent  
10 have voted in favor of this transaction to take the money  
11 and let the company go private.

12 The plaintiffs in this case, the appellants have  
13 done nothing to undermine the disclosures; they had an  
14 opportunity, prior to this transaction, closing to seek to  
15 expand those proxy disclosures, to go to the court and  
16 say, we think this is misleading, it's incomplete, we need  
17 more information. They didn't do that, the vote happened,  
18 99.8 percent voted in favor, and now they come to the  
19 court and ask the court to upset that decision.

20 JUDGE PIGOTT: Thank you, Mr. Stern.

21 MR. STERN: Thank you.

22 JUDGE PIGOTT: Mr. Rudy.

23 MR. RUDY: Thank you.

24 Alpert said when there is a - - - when there is  
25 majority ownership, the inherent conflict of interest and

1 the potential for self-dealing requires careful scrutiny  
2 of the transaction.

3 JUDGE GARCIA: But again, if we can just go  
4 back to Alpert and step up for a second, and I think  
5 it's clear Alpert did not apply to this situation.  
6 So now you've got a case where they've put in these  
7 two procedural protections to try to create an arm's  
8 length transaction. So you've got a special  
9 committee and you've got a majority-minority vote.

10 MR. RUDY: Right.

11 JUDGE GARCIA: And I'm having trouble  
12 understanding why we would then, under that analysis  
13 where you look at fairness, apply that same standard  
14 where these protections weren't in place.

15 MR. RUDY: Well, the - - - what you would  
16 do is what happened in Alpert. In Alpert, they  
17 looked at the transaction, and they found out - - -  
18 and they concluded that it was fair. I mean, you  
19 would take those factors, as Alpert said, use special  
20 committees, use votes, and their facts to be  
21 considered as part of the fair-dealing prong - - -

22 JUDGE GARCIA: And - - -

23 MR. RUDY: - - - and so, and I don't think  
24 there is any reason - - - here is the policy as I see  
25 it. There is no good transaction that's being

1           deterred by the entire fairness standard.

2                   JUDGE PIGOTT: I'm not sure about that,  
3           because I was thinking about that, why don't we just  
4           do that? Why don't we just say what's fair? I mean,  
5           everybody likes what's fair.

6                   But if I was in your shoes, or if I was a  
7           minority, and the transaction is going down for  
8           \$15.25, I'll bet I can convince them, you want three  
9           years of litigation or do you want to make it  
10          sixteen?

11                   I just think that what you're suggesting is that  
12          rather than rely on business judgment, you take advantage  
13          of what you want to say is fairness to - - -

14                   MR. RUDY: Your Honor, you're assuming I am  
15          in the boardroom. I'm not - - - I'm here after the  
16          fact. This is - - - that's the conversation between  
17          the directors and the controller.

18                   JUDGE PIGOTT: I'm understanding you, but  
19          what I'm saying is you're saying that's - - - that  
20          the minority shareholders who don't like this can sue  
21          regardless - - - they keep talking about ninety-nine  
22          percent, and I know that's not - - -

23                   MR. RUDY: I'd like to get to that if I - -  
24          -

25                   JUDGE PIGOTT: I know.

1 MR. RUDY: - - - if I could, yeah.

2 JUDGE PIGOTT: Okay. Go ahead.

3 MR. RUDY: Well, Your Honor, first of all,  
4 I - - - the ninety-nine percent number is a highly  
5 misleading figure that they've presented front and  
6 center. Between the announcement of this deal and  
7 the vote on this deal, seventeen million shares of  
8 Kenneth Cole stock traded hands.

9 The shareholders who didn't like this deal voted  
10 with their feet. The shareholders who wanted this deal  
11 bought those shares, and eighty percent of the people of  
12 the minority stockholders then cast votes in favor - - -  
13 cast votes, and of the eighty percent who cast votes, 99.8  
14 voted yes.

15 It's not a particular - - -

16 JUDGE GARCIA: Isn't the par - - - that the  
17 public saying, there is a segment of the public that  
18 thinks this is a good deal? I mean, it's the market.

19 MR. RUDY: There is a segment of the public  
20 that thinks it's a good deal. Those people bought  
21 shares to get the deal.

22 JUDGE GARCIA: Right.

23 MR. RUDY: Right. And then there is a lot  
24 of people like my client, a public pension fund who  
25 says, we don't like this deal.

1 JUDGE GARCIA: And they could vote no.

2 MR. RUDY: And they - - - well, they can  
3 vote no and they can't seek appraisal, and they have  
4 no rights to improve the price or get anything - - -

5 JUDGE GARCIA: It's a publicly traded  
6 company, right?

7 MR. RUDY: Right.

8 JUDGE GARCIA: The price is set by the  
9 market.

10 MR. RUDY: That is correct. But the - - -  
11 but stockholders of New York corporations know, under  
12 Alpert - - - or should know that they have a right to  
13 contest transactions and get a fair price through  
14 litigation if they think it's unfair. Otherwise  
15 you're totally at the whim of the - - - of a - - -

16 JUDGE GARCIA: But doesn't that go to Judge  
17 Pigott's point, like, they could get a price because  
18 we're applying this rule, and, you know, they know  
19 three years of litigation will get you a higher  
20 price?

21 MR. RUDY: Well, I don't think there's any  
22 evidence that stock - - - controlling stockholders  
23 are pro - - - are stopping themselves from offering  
24 deals to stockholders. There is lots of evidence  
25 that special committees and minority votes fail to

1 protect stockholders.

2 If I could, Your Honor, I just had a couple  
3 of points. The - - - you know, I think it's  
4 important to recognize that Judge - - - as Judge  
5 Levine's brief said, this is a court that has set a  
6 long - - - has a long history of setting a higher  
7 fiduciary standard than Delaware. I know that MFW is  
8 an attractive option because it's tidy and it's long  
9 and it's complicated and it's technical, but to  
10 impose that in this state with different statutory  
11 regime is not necessarily the one size fits all that  
12 perhaps we'd want it to be.

13 I think it's also interesting to hear Mr.  
14 Mundiya talk about the Dole decision, which was our firm's  
15 case. The Dole decision had a majority-minority vote, and  
16 it had a controlling - - - a special committee, but after  
17 discovery, those provisions were shown to be lacking.

18 He said there was highly particularized  
19 allegations in that complaint; that's just flatly wrong.  
20 The complaint didn't say anything more than our current  
21 complaint says. But then we got discovery, and we sh - -  
22 - and we proved that the special committee, which was well  
23 meaning and trying its best - - - which could've happened  
24 here, maybe the special committee was doing its best but  
25 got defrauded, like the committee did in Dole.

1                   So, I think - - - I think that's all I have,  
2                   Your Honor. Thank you.

3                   JUDGE PIGOTT: Thank you, sir.

4                   (Court is adjourned)

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C E R T I F I C A T I O N

I, Meir Sabbah, certify that the foregoing transcript of proceedings in the Court of Appeals of Matter of Kenneth Cole Productions, Inc., Shareholder Derivative Litigation, No. 54 was prepared using the required transcription equipment and is a true and accurate record of the proceedings.



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