

Ioffe v Madden

2012 NY Slip Op 33521(U)

September 13, 2012

Sup Ct, Queens County

Docket Number: 700188/2012

Judge: Marguerite A. Grays

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Short Form Order

NEW YORK SUPREME COURT - QUEENS COUNTY

Present: **HONORABLE MARGUERITE A. GRAYS**
Justice

IAS PART 4

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MARK IOFFE and CATHERINE L. PHILLIPS,
and Derivatively on Behalf of Nominal Defendant
STEVEN MADDEN, LTD.,

Plaintiff(s),

-against-

STEVEN MADDEN, EDWARD R. ROSENFELD,
JOHN L. MADDEN, PETER MIGLIORINI,
RICHARD P. RANDALL, RAVI SACHDEV and
THOMAS H. SCHWARTZ,

Defendant(s).

and

STEVEN MADDEN, LTD.

Nominal Defendant
-----X

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Motion
Dated: June 12, 2012

Motion
Cal. No.:

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The following papers numbered 1 to 10 read on this motion by nominal defendant Steven Madden, Ltd, defendant Edward R. Rosenfeld, defendant John L. Madden, defendant Peter Migliorini, defendant Richard P. Randall, defendant Ravi Sachdev, and defendant Thomas H.Schwartz for an order pursuant to CPLR §3211(a)(7) dismissing the complaints against them and on this motion by Steven Madden for an order pursuant to CPLR§ 3211(a)(7) dismissing the complaints against him.

	<u>Papers</u> <u>Numbered</u>
Notice of Motion - Affidavits - Exhibits	1-2
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Upon the foregoing papers it is ordered that the motions are determined as follows:

Plaintiff Mark Ioffe and plaintiff Catherine Phillips claim to be aggrieved because the Board of Directors of Steven Madden, Ltd., a corporation they invested in, amended the employment contract of Steven Madden so as to increase his compensation. On February 2, 2012, plaintiff Ioffe brought a shareholder derivative action asserting, *inter alia*, causes of action for breach of fiduciary duty against the board, and on the same day plaintiff Phillips brought a similar action.

Steven Madden, Ltd., incorporated in Delaware, sells footwear and fashion accessories on a global basis. In 1990, Steven Madden founded the company, which uses his name on its major line of products. Madden, who once served as the company's Chief Executive Officer and Chairman of the Board, now holds the position of Creative and Design Chief. The board has six members, Edward R. Rosenfeld, John L. Madden, Peter Migliorini, Richard P. Randall, Ravi Sahdev, and Thomas H. Schwartz. Rosenfeld also serves as the company's Chief Executive Officer, and John L. Madden is the brother of Steven Madden.

Madden's employment as the Company's Creative Design Chief is the subject of a written employment agreement (the "Second Amended Employment Agreement"). The agreement was amended in 2005 (the "third Amended Employment Agreement" or "Prior Agreement"). In December 2011, the Company and Madden amended the Prior Agreement. In February 2012, the Company revised the amended agreement (the "Amended and Restated Second Amendment to Third Amended Employment Agreement").

The latest amendment set Madden's base salary beginning on January 1, 2012 at \$5,416,667, with adjustments in 2013, 2014, 2015 and 2016. Additionally, it extended the term of Madden's employment through December 31, 2023. The agreement further revised the terms of a \$3,000,000 secured loan the company made to Madden in 2007. The revisions to the terms of the loan eliminated the accrual of interest from January 1, 2012 forward and established a ten-year gradual forgiveness of the loan principal and interest already accrued.

According to the plaintiffs, the guaranteed compensation equals approximately one-half of the company's net income for the past ten years. Additionally, plaintiffs contend that Maddens 2012 salary, is almost eight times his 2010 salary and was entered into when there was eight years still on the prior employment agreement. Defendants contend, however, that the board utilized James F. Reda & Associates to advise it on compensation matters, and it received expert advice from this source before entering into the amendments to Madden's employment agreement. The board succeeded in obtaining "give backs" from Madden, allegedly including a reduction in his cash salary and the elimination of cash bonuses and an expense account. Madden received in exchange enhanced stock options, allegedly

thereby benefitting him and also benefitting the company since Madden had an increased incentive to remain in his position as the Creative and Design Chief for the company. Additionally, the company has performed well over the last several years. Gross revenue almost doubled from \$338,134,000 in 2004 to \$635,418,000 in 2010. The price of the company's shares increased from \$5.82 on July 15, 2005 to \$34.96 on January 3, 2012.

Defendants now move to dismiss this action pursuant to CPLR §3211(a)(7), arguing that the plaintiffs have failed to state a cause of action.

On a motion to dismiss pursuant to CPLR §3211, the pleadings are afforded a liberal construction and the Court accepts facts as alleged in the complaint as true, accords plaintiff the benefit of every possible favorable inference, and determines only whether the facts as alleged fit within any cognizable legal theory (*Morone v Morone*, 50 NY2d 481; *Rovello v Orofino Realty Co.*, 40 NY2d 633 [1976]). In determining whether a complaint is sufficient to withstand a motion pursuant to CPLR §3211 (a)(7), the sole criterion is whether the plaintiff has a cause of action, not whether he has stated one (*Leon v Martinez*, 84 NY2d 83 [1994]; *Guggenheimer v Ginzburg*, 43 NY2d 268 [1977]). If, upon examination of the four corners of the pleadings, factual allegations are discerned which taken together manifest any cause of action cognizable at law, a motion for dismissal will fail (*Guggenheimer v Ginzburg*, 43 NY2d 268; *1414 Realty Corp. v G&G Realty Co.*, 272 AD2d 309 [2000]; *Sanders v. Winship*, 57 NY2d 391 [1982]; *511 W 232nd Owners Corp. v Jennifer Realty Co.*, 98 NY2d 144; *Polonetsky v Better Homes Depot, Inc.*, 97 NY2d 46; *Porcelli v Key Food Stores Co-op, Inc.*, 44 AD3d 1020 [2007]).

The parties agree that the law of Delaware, the state of the company's incorporation, applies to the case at bar. (*See, O'Donnell v. Ferro*, 303 AD2d 567; *Wilson v. Tully*, 243 AD2d 229.) Delaware law makes provision for a demand on the board of directors of a corporation to address a wrong before a shareholder can commence a derivative action. (*See, David Shaev Profit Sharing Account v. Cayne*, 24 AD3d 154.)

Delaware Chancery Court Rule 23.1 provides that every shareholder derivative complaint shall "allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort." (*See, O'Donnell v. Ferro, supra; Aronson v. Lewis*, 473 A.2d 805 [Del.,1984].) The plaintiffs herein did not make a demand upon the board before commencing their shareholder derivative actions.

"Under Delaware law, the rule that a shareholder must make a demand upon a corporation's directors before initiating a derivative suit, unless such demand would be futile,

is more than a mere pleading requirement; it is a substantive right.” (*Starrels v. First Nat. Bank of Chicago*, 870 F.2d 1168, 1171.)

Delaware law does not require a plaintiff to make a futile demand upon the board. (*See, Aronson v. Lewis, supra.*) The cited case sets forth a two-pronged test for demand futility. The first is “whether, under the particularized facts alleged, a reasonable doubt is created that*** the directors are disinterested and independent.” (*Aronson v. Lewis, supra*, 814; *Brehm v. Eisner*, 746 A.2d 244.) “That is, were they incapable, due to personal interest or domination and control, of objectively evaluating a demand, if made, that the Board assert the corporation's claims that are raised by plaintiffs or otherwise remedy the alleged injury?” (*Brehm v. Eisner, supra*, 257.) The second prong is whether the pleading creates a reasonable doubt that “the challenged transaction was otherwise the product of a valid exercise of business judgment.” (*Aronson v. Lewis, supra*, 814; *Brehm v. Eisner, supra.*) “These prongs are in the disjunctive. Therefore, if either prong is satisfied, demand is excused.” (*Brehm v. Eisner, supra*, 256.)

The plaintiffs herein failed to satisfy the first prong of the test. Where, as in the case at bar, a board has an even number of members, the plaintiff need only show that half of them are not independent. (*Beam ex rel. Martha Stewart Living Omnimedia, Inc.*, 845 A.2d 1040, fn 8.) In the case at bar, the plaintiffs succeeded in showing that only one out of six directors lacked independence. Although there is some authority for the proposition that a board member does not lack independence just because of family ties, this court finds that John Madden, the brother of Steven, could not objectively decide if bringing suit was in the best interest of the corporation. (*See, Grimes v. Donald*, 673 A.2d 1207, 1216 [“The basis for claiming excusal would normally be that: (1) a majority of the board has a material financial or familial interest ***”].) This court finds that Edward R. Rosenfeld did not lack independence merely because he served as both a director and as the CEO of the corporation. (*See, Beam ex rel. Martha Stewart Living Omnimedia, Inc., supra.*) Finally, the directors are not tainted by interest on the supposition that they will not authorize a suit for breach of fiduciary duty against themselves. The acceptance of the plaintiffs’ argument in this regard would “effectively abrogate Rule 23.1 and weaken the managerial power of directors,” and “a bare claim of this sort raises no legally cognizable issue under Delaware corporate law.” (*Aronson v. Lewis, supra*, 818.) “It is no answer to say that demand is necessarily futile because (a) the directors ‘would have to sue themselves, thereby placing the conduct of the litigation in hostile hands,’ or (b) that they approved the underlying transaction.” (*Brehm v. Eisner, supra*, 257, fn 34, quoting *Aronson v. Lewis, supra*, 818.) “[T]he mere threat of personal liability for approving a questioned transaction, standing alone, is insufficient to challenge either the independence or disinterestedness of directors ***.” (*Aronson v. Lewis, supra*, 815.) In *Aronson*, the Delaware Supreme Court “held that ‘the mere threat of personal liability *** is insufficient to challenge either the independence or disinterestedness

of directors' and that a reasonable doubt that a majority of directors is incapable of considering [a] demand should only be found where 'a substantial likelihood of personal liability exists.'" (*Wood v. Baum*, 953 A.2d 136, 141, fn 11, quoting *Aronson v. Lewis*, *supra*, 814.) Because of the business judgment rule, there is no substantial likelihood of personal liability in this case.

The plaintiffs herein also failed to satisfy the second prong of the test. "Chancery Rule 23.1 requires, in part, that the plaintiff must allege with particularity facts raising a reasonable doubt that the corporate action being questioned was properly the product of business judgment ***." (*Brehm v. Eisner*, 746 A.2d 244, 254 -255.) "The business judgment rule is a presumption that in making a business decision, not involving self-interest, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." (*Spiegel v. Buntrock*, 571 A.2d 767, 774.) The plaintiffs herein have not plead facts sufficient to create a reasonable doubt concerning whether the directors are entitled to rely on the business judgment rule. The plaintiffs make no allegation that the directors personally profited from enhancing Steven Madden's compensation package or otherwise engaged in self-dealing. The company, which has flourished, is heavily reliant on Steven Madden's creative talents and name, matters which were surely taken into account, and the level of his compensation involves a determination properly left to the Board of Directors.

Accordingly, the defendants motions are granted.

Dated: SEP 13 2012



J.S.C.