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Federal Court Rules Investment Fund is 10 Percent Owner in Section 16 Case

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On August 20, a federal magistrate judge in the Eastern District of New York granted a motion for summary judgment in a derivative case brought against purported 10 percent stockholders of 1-800-Flowers.com, Inc. Pursuant to Section 16 of the Securities Exchange Act of 1934, as amended, the judge found a hedge fund liable as a 10 percent owner, despite the fact that it had delegated voting and investment authority to its investment adviser.

By way of background, Raging Capital Master Fund (the “Master Fund”) owned more than 10 percent of the common stock of 1-800-Flowers.com. The Master Fund then delegated voting and investment authority in the shares to its registered investment adviser, Raging Capital Management. The stock holdings were publicly reported by the Master Fund, Raging Capital Management and its managing member, William Martin, on a Schedule 13G, but no Forms 3 or 4 were ever filed.

The plaintiff alleged that the defendants, as 10 percent owners, were required to disgorge short-swing profits under Section 16(b).

The defendants argued that 1) the Master Fund did not have beneficial ownership over the shares and accordingly was not subject to Section 16 because it had delegated voting and investment authority to Raging Capital Management and could not acquire voting and investment authority within 60 days; 2) Raging Capital Management was not subject to Section 16 because it was a registered investment adviser pursuant to Rule 16a-1(a)(1)(v); and 3) Martin was not subject to Section 16 because he was a qualifying control person pursuant to Rule 16a-1(a)(1)(vii).

In finding that the Master Fund was a 10 percent owner within the meaning of Section 16, the judge noted that the investment management agreement explicitly provided for Raging Capital Management to act as the “agent” of the Master Fund for all purposes and the parties had the power to alter or even terminate the management agreement at any time. Finally, the judge emphasized that the three defendants were not unaffiliated (or independent) parties, indicating that a delegation of voting and investment authority to an unaffiliated third party may be treated differently. Accordingly,

the judge found that there was no effective delegation for purposes of Section 16 and the Master Fund was held liable for short-swing profits. The fact that Raging Capital Management and Martin could rely on exemptions from Section 16 did not alter the final result. The judge found it unnecessary to resolve whether the Master Fund, Raging Capital Management and Martin constituted a “group” whose holding should be aggregated for purposes of the 10 percent owner determination, because the Master Fund alone held in excess of 10 percent of the 1-800-Flowers.com common stock.

Finally, the judge found that the plaintiff was not entitled to any prejudgment interest because there was no showing the defendants acted in bad faith. The judge observed that the matter was complex and that the defendants had acted in good faith, publicly disclosing their ownership in a Schedule 13G filing.

The case is captioned *Brad Packer*, derivatively on behalf of *1-800-Flowers.com, Inc. v. Raging Management, LLC, Raging Capital Master Fund, Ltd, William C. Martin and 1-800-Flowers.com, Inc.*

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