

Turning The Stock Tables

Skadden employed litigation jujitsu, turning the plaintiffs' own statements about share inflation against them.



THE STORY IS ALL TOO FAMILIAR: Two corporate giants announce a merger with fanfare, and the CEOs do a star turn on CNBC, chatting about synergy and economies of scale. But soon the union hits a bad patch as one discovers that the other has been cooking the books. Recriminations are made; earnings are restated; forensic audits are launched. The stock goes into free fall, and a shareholder litigation banquet ensues.

Usually this story ends with the surviving company suffering an acute case of buyer's remorse and holding a steep bill from shareholders. But Jonathan Lerner is trying to rewrite that script. The 53-year-old litigation partner at New York's Skadden, Arps, Slate, Meagher & Flom is representing San Francisco-based McKesson Corporation in securities litigation arising out of its 1999 acquisition of Atlanta-based health software giant HBO & Company. Four months after the deal was done, McKesson announced that HBOC had booked revenue from contingent sales of its software—many of which never went through. A financial audit turned up \$327 million of improperly recorded transactions, at least \$50 million of which were likely to be complete losses. Unsurprisingly, the stock of McKesson (then called McKesson HBOC, Inc.) tanked, losing about \$9 billion in market capitalization.

More than 80 shareholder suits were brought against McKesson HBOC, most of which were consolidated into a federal case led by the New York State Common Retirement Fund, Inc., which alleged 16 violations of federal securities laws. Lerner succeeded

in getting nine of the claims dismissed with prejudice, and six of the seven others dismissed with leave to amend. Then Lerner and McKesson turned up the heat. Lerner reasoned that if any group had benefited from the tricky accounting, it was the former HBOC shareholders now suing his client. After all, the price for HBOC was based in large part on the bogus financial data. Had McKesson known the truth, the deal would have been done on very different terms—if at all. HBOC's shareholders had reaped a windfall from the company's deception, at McKesson's expense.

In January of last year the company filed a counterclaim against the shareholders for unjust enrichment. In filing the claim, Lerner employed a little litigation jujitsu, turning the plaintiffs' own statements that HBOC's shares were "improperly inflated" against them. Lerner's claim was also helped by the structure of the McKesson HBOC merger, in which a newly created subsidiary of McKesson was merged into HBOC, which in turn was then owned by a new entity named McKesson HBOC (a so-called reverse triangular merger). The structure helped both build a firewall to protect McKesson from HBOC's actions and preserve the separate character of HBOC within the merged company.

How was Lerner's gambit received? As of December 1, the court had not ruled on the shareholders' motion to dismiss. But Max

Berger, a partner with New York's Bernstein Litowitz Berger & Grossmann and co-lead counsel for the shareholders, labels the claim a litigation tactic designed to pressure his clients. "We've never run into this before, and it's without merit," says Berger. "You can't say to tens of thousands of innocent shareholders of a public corporation, 'Give us our money back.' They aren't guarantors." Berger adds that plaintiffs don't accept that McKesson had clean hands in the merger. As to the dismissal of a big chunk of his clients' claims, Berger was philosophical: "We were disappointed, but it's still early in the process. There will be other victories and losses."

The shareholders' second amended complaint was filed in November 2000. McKesson's motion to dismiss the amended complaint was argued in March of last year. At the same hearing, the shareholders brought their motion to dismiss McKesson's claim for unjust enrichment. The judge has not ruled on either motion.

—DOUGLAS MCCOLLAM

DEPARTMENT
SIZE

Partners 96
Associates 369

DEPARTMENT AS
PERCENT OF FIRM

Partners 28.32%
Associates 30.27%

ESTIMATED PERCENT
OF FIRM REVENUE 2001

Undisclosed

DEPARTMENT HIGHLIGHTS Won a defense verdict for the National Football League in a billion-dollar antitrust case brought by The Oakland Raiders . . . Obtained reversal of class certification of Jewish customers alleging discrimination against Avis Rent-A-Car Systems, Inc. . . . Currently representing Northeast Utilities in case against Consolidated Edison, Inc., arising from Con Ed's refusal to proceed with \$3.7 billion merger.

PRO BONO HIGHLIGHT Brought suit on behalf of African American residents of Morgan City, Louisiana, alleging violations of the Voting Rights Act. At-large city council elections had resulted in no African American ever being elected despite their constituting 22 percent of the population. The city switched to a single-member district method, whereupon an African American was elected.

Ames, a discount retailer with 348 stores located throughout the Northeast, South, and Great Lakes states, is relying on general counsel **Earl Spector**. Ames has also retained regular outside counsel **Norman Asher, Katharine Bachman, Jay Bothwick, John Burgess**, and associates **Yvette Beeman, Iushna Heneghan, Norman Pederson III, and Paul Rogers** of Boston's **Hale and Orr**.

Zayre, which is based in Framingham, Massachusetts, is relying on general counsel **Jay Meltzer** and in-housers **Kevin Fox and Ann McCauley**. Zayre has also turned to regular outside counsel **Fred Becker, Douglass Ellis, Jr., Arthur Siler**, and associates **Kevin Carome, Daniel Evans, Stephen Van Meter, and Jonathan Zorn** of Boston's **Ropes & Gray**.

—Audrey Duff

COLGATE-PALMOLIVE/CLAYTON & DUBILIER: On September 13 New York-based Colgate-Palmolive Company agreed to sell its Boston-based subsidiary, The Kendall Company, to the New York-based leveraged buyout firm of Clayton & Dubilier, Inc., for \$972.4 million. The Kendall acquisition is Clayton & Dubilier's largest divestiture-leveraged buyout ever. Kendall had been a wholly owned subsidiary of Colgate-Palmolive since 1972.

Clayton & Dubilier has called on regular outside counsel **Steven Aiden, Meredith Brown, Robert Cubitto, James Kiernan III, John Niles**, and associates **Michael Blair, David Brittenham, Michael Harrell, Azizah al-Hibri, Cheryl Johnson, Kenneth Monteiro, and Charles Ruys de Perez** of New York's **Debevoise & Plimpton**. Clayton & Dubilier's financial adviser, Drexel Burnham Lambert Incorporated, has tapped regular outside counsel **Philip Coviello** and associates **Sharon Bowen and John Hart** of the New York office of Los Angeles's **Latham & Watkins**, as well as associate **Jeremy Glaser** of the firm's Costa Mesa, California, office.

Colgate-Palmolive is relying on vice-president and general counsel **Harold Obstler** and in-housers **Frederick Cowles, Nina Gillman, William Peters, and Douglas Tormey**, as well as regular outside counsel **John Schuster, Robert Usadi**, and associates **Charles Baugh, Patricia Peterson, and Peter Vogelsang** of New York's **Cahill Gordon & Reindel**.

—Alessandro G. Olivieri

DOW CHEMICAL/ESSEX CHEMICAL: On September 5 Clifton, New Jersey-based Essex Chemical Corporation agreed to be acquired by The Dow Chemical Company, based in Midland, Michigan, for \$366 million. Dow stepped into the fight between Essex and Gurit-Heberlein AG as a friendly suitor at Essex's request.

Editor's note: Big Deals are placed regionally according to the location of the company or subsidiary being acquired or seeking financing.

Reinstein, and associate **Donna Boehme** of New York's **Fried, Frank, Harris, Shriver & Jacobson**.

Essex successfully fought off Wattwil, Switzerland-based Gurit-Heberlein's hostile bid when a New Jersey federal court blocked Gurit-Heberlein. Essex's partner in a European joint venture, from pursuing its tender offer.

Essex is relying on general counsel **Donald**

Essex's financial advisers, **PaineWebber Incorporated** and **Thomson McKinnon Securities Inc.**, are both counting on **PaineWebber's** regular outside counsel, **Lewis Clayton, James Dubin, John McEnroe**, and associates **Jay Itzkowitz and Richard Starr** of New York's **Paul, Weiss, Rifkind, Wharton & Garrison**.

—Karen Dillon

PLAYTEX HOLDINGS INC.: To negotiate a

DEALMAKER



Jonathan Lerner

When Jonathan Lerner, 40, a partner at New York's Skadden, Arps, Slate, Meagher & Flom, defended Essex Chemical Corporation in its heated takeover battle against Gurit-Heberlein AG, he transformed a standard stall tactic into an insurmountable hurdle for the Swiss chemical company. By blocking Gurit's \$148 million May 31 tender offer, Lerner bought his client time to set up an auction and find a friendly bidder at a higher price. Essex ultimately accepted a \$366 million offer from Midland, Michigan-based The Dow Chemical Company.

Lerner, a hostile takeover specialist, maintained that Gurit, Essex's longtime partner in a profitable joint venture, could not pursue the tender offer because it had not disclosed material information. But at the same time, he argued, Gurit could not disclose that material information because it was bound by the joint venture agreement.

Lerner's victory was sealed on August 22 when the Third Circuit Court of Appeals affirmed (without opinion) federal district judge John Bissell's preliminary injunction prohibiting Wattwil, Switzerland-based Gurit from pursuing a tender offer for Essex.

"I think that the victory was a very substantial one because it is unusual to receive a preliminary injunction that was so extended. . . . We were capable of get-

ting a superb price for the company because we didn't have a gun to our heads," says Skadden, Arps partner Martha McGarry, lead corporate counsel for Clifton, New Jersey-based Essex.

"Going in we knew that this case had strong potential to be a showstopper," maintains Lerner. Although he admits that the results were highly unusual, he contends that it was clear—after his team reviewed the facts, which included 18 depositions and more than 100,000 pages of expedited discovery, mostly in German—that Gurit had not disclosed material information.

Gurit's counsel, Harvey Sperry of New York's Willkie Farr & Gallagher, says it was a judgment call whether the undisclosed information was actually material, but he adds that Lerner effectively argued his case before the judge.

"[Lerner] was able to put together material information along with provisions of the joint venture agreement," says Sperry. "It took good lawyering to do it, but what Lerner . . . really did was to convince the judge to extend the time period during which Essex could seek out other buyers."

"Jonathan is the one that tied it all together," says Jack Polite, then chairman, president, and chief executive of Essex. "[He]'s probably my impression of the ultimate lawyer . . . the kind of man with the innate ability to understand his client," he adds.

Unusual takeover litigation is becoming a habit for Lerner. He specifically cites financier Martin Sosnoff's unsolicited bid for Caesars World, Inc., in 1987. "Discovery led to the conclusion that serious securities and margin violations were made," says Lerner. Subsequently a federal judge issued a preliminary injunction abruptly halting Sosnoff's tender offer.

Says Barry Garfinkel, head of Skadden, Arps's litigation practice: "[Lerner]'s a highly talented, creative, and aggressive lawyer . . . a bulldog at finding issues and developing them."

—Audrey Duff