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SDSBS Teams Up To Win Landmark Victory

Perelman: $1.58 Billion
Morgan Stanley: 0

On May 18, 2005, a jury in West Palm Beach, Florida delivered an historic judgment against Morgan Stanley & Co. on behalf of financier Ronald O. Perelman's company, Coleman (Parent) Holdings, Inc. The jury found the investment banking firm liable for its role in a fraud relating to the 1998 sale of The Coleman Company, the well-known camping gear manufacturer, to Sunbeam Corporation, known for its production of small household appliances. The award (for compensatory and punitive damages) totaled almost $1.45 billion. This is reportedly the largest judgment ever returned in the U.S. for the benefit of a single individual. The case was marked by the defendant's extra-ordinary efforts to evade its court-ordered obligations to produce evidence, and its accusations of improper conduct against everyone from the judge to its own lawyers.

It was a David vs. Goliath battle between one of the nation's most astute investors, Mr. Perelman, and a group of equally astute investment bankers. Mr. Perelman's David, however, had the determination, the resources, and the highly-skilled legal team necessary to pursue Morgan's Goliath to a spectacular decision. He also had the great fortune of having the battle take place before Palm Beach County Circuit Court Judge Elizabeth T. Maass, an extremely competent jurist who found herself and the integrity of the legal system challenged by Morgan's aggressive behavior at every turn.

Mr. Perelman charged that the investment firm had participated in a massive fraud involving the 1998 sale of Coleman to Sunbeam. In December, 1997, Mr. Perelman, who owned controlling interest in Coleman (with 82% of its stock) was approached by Sunbeam's new chief executive, Mr. Albert ("Chainsaw Al") Dunlap, with an offer to buy Coleman. Discussions went poorly and the two men parted with-out agreement. Shortly thereafter, Morgan re-initiated contact with Mr. Perelman on behalf of Sunbeam, and negotiated a deal for the sale of Coleman to Sunbeam. Morgan had brokered the first of many deals with Mr. Perelman 20 years ago, and Mr. Perelman felt confident in working directly with Morgan. The sale, completed in March 1998, was calculated to net Mr. Perelman about $1.5 billion, $680 million of which was in Sunbeam stock. As Sunbeam's exclusive investment banker, Morgan earned a $10 million fee on completing the deal.

"Justice is most often depicted in art as a woman. She is blindfolded. In one hand she holds scales, and in the other hand a sword. The reason for the blindfold is because justice is, indeed, blind to power, position, wealth, religion, national origin. Those things do not matter. The scale is there so that equity and justice may be accurately weighed. And when the scale is placed out of balance, when it is tipped in a way that results in injustice, that strong and powerful woman is prepared to use her sword in order to restore the balance, in order to make certain that the scales are not tipped unfairly again. Each of you, no matter what your gender may be, have your hand on that sword. It is an awesome responsibility. It is a tremendous power that you have."

Just weeks after the deal closed, the market value of Mr. Perelman's Sunbeam holdings began to evaporate. Newly published sales and earnings figures dramatically conflicted with earlier Sunbeam statements that had been backed-up by Morgan. The revelations led to the ouster of Sunbeam CEO Dunlap, and then its accountant, Arthur Andersen, withdrew an audit of the company's books. The Securities and Exchange Commission (SEC) later charged Mr. Dunlap with fraud in "cooking the books" of Sunbeam to create an illusion of financial success brought about by his leadership, when, in fact, the company was in deep financial trouble. Mr. Dunlap was later fined by the SEC and barred for life from running any public company because of the fraud he had conducted at Sunbeam. In 2001, after efforts to save the doomed company failed, Sunbeam filed for bankruptcy and all of Sunbeam's shareholders, including Mr. Perelman, were left holding worthless stock. Unable to seek meaningful compensation from bankrupt Sunbeam, Mr. Perelman focused on Andersen's role in contributing to Sunbeam's demise.

During the course of the Andersen litigation, Mr. Perelman's legal team discovered a letter dated just days before the Coleman-Sunbeam deal was to close. That letter from Andersen to Morgan Stanley was delivered to Morgan, as the bank also prepared to close Sunbeam's $750 million bond offering needed to finance the Coleman deal. The letter outlined serious financial troubles at Sunbeam, including decreasing sales, escalating debts, and accumulating losses. Rather than face the loss of tens of millions of dollars in transaction fees, Morgan Stanley made the decision to help conceal Sunbeam's true condition. A press release drafted with Morgan's cooperation and issued by Sunbeam with Morgan's approval continued to paint a grossly misleading picture of Sunbeam's economic performance. Other documents prepared by Morgan for Sunbeam's bond offering further misrepresented Sunbeam's financial condition, enabling Morgan to attract enough other deceived investors to earn a $22.5 million fee for its work on that offering. A week after the offering closed, Sunbeam acknowledged that its sales would fall dramatically short of earlier estimates. Three years later, Sunbeam filed for bankruptcy.

Morgan Stanley argued that it had accurately reported all of the information available to it at the time, and that it, too, was being lied to by Sunbeam. Mr. Perelman's position was that Morgan not only knew of the financial difficulties behind the scenes, but had a hand in preparing documents that concealed the financial ill health of Sunbeam, and had a duty to make accurate disclosures to Mr. Perelman even though Morgan sat on the opposite side of the negotiating table. In May 2003, after months of investigation, argument, and fruitless negotiating efforts between the parties, Mr. Perelman sued.

Legendary litigator Jerold Solovy, the highly-respected Chairman of the 400-plus lawyer Chicago-based firm, Jenner & Block, was chosen as the primary architect of Mr. Perelman's trial strategy. Mr. Solovy had successfully partnered with Jack Scarola of Searcy Denney Scarola Barnhart & Shipley to secure a $70 million settlement on behalf of Mr. Perelman against Arthur Andersen. When the battle lines formed with Morgan Stanley, Mr. Perelman and Mr. Solovy naturally turned once again to Searcy Denney Scarola Barnhart & Shipley and Jack Scarola to round out the trial team.

From the very beginning and throughout the trial, counsel for the defendant battled aggressively with the plaintiff, plaintiff's counsel, and the judge. During discovery before the trial, Morgan engaged in protracted, deliberate and concerted efforts to delay and obstruct the litigation by failing to produce e-mail and other documents demanded by the plaintiff and ordered to be produced by the court; by destruction of evidence; by representing that documents had been destroyed when it knew back-up and archived data existed; by concealing the fact that its lead banker on the merger was being criminally prosecuted for complicity in bribery at the very time he was representing Morgan on the merger; and by falsely certifying to plaintiff and the court that it had searched for, located and disclosed documents.

Jack Scarola

Confronted with compelling and largely unrefuted evidence of Morgan Stanley's misconduct, Judge Maass responded at several critical junctures in the trial with tempered restraint. At each step, she opted for carefully measured, minimal sanctions against Morgan expressly directed at correcting the imbalances created by the misconduct rather than punishment. Morgan's response was to continue to evade court orders and to openly charge the judge with bias and emotionalism. As Morgan's conduct continued unabated, the Court was compelled to escalate the level of sanctions imposed against Morgan in an effort to alleviate the harm done to the plaintiff by Morgan's repeated and intentional violation of court orders.

In March 2005, shortly before the trial began and following days of evidentiary hearings, Judge Maass concluded that the abuses by Morgan during discovery had come to "infect the entire case", and she announced her intention to issue a partial default order, directing the jury to accept as established fact that Morgan had conspired with and assisted Sunbeam in perpetrating a fraud. Morgan had forfeited its right to defend itself only on those issues directly related to the evidence that Morgan had destroyed or concealed. The court stopped significantly short of the full relief available under Florida's procedural rules and well-established case law. In an obvious effort to buy more time and divert attention from its own misconduct, Morgan notified the judge that it intended to fire its own lead counsel – that very day, without notice – and asked for a six-month continuance to find new counsel. Noting that two other law firms had been actively defending Morgan for months, the judge denied the request.

As the Court summarized its findings, "[D]iscovery abuses and misrepresentations by Morgan Stanley . . . would take a volume to recite . . . Morgan Stanley has deliberately and contumaciously violated numerous discovery orders . . . it chose to hide information about its violations and coach witnesses to avoid any mention of additional, undisclosed problems. . . . the prejudice to [Mr. Perelman and Coleman (Parent) Holdings, Inc.] from these failings cannot be cured . . ." The jury was instructed to accept as fact that the investment bank participated in a scheme to mislead Mr. Perelman and to cover up its involvement in Sunbeam's fraud on Mr. Perelman. Considering Morgan's relentless assault on the integrity of the judicial system, and its persistent and serious abuses, the trial court's measured response was not only justified but essential. However, the court's order left significant issues open for trial and Morgan had plenty of fight and virtually limitless resources left to continue its relentless defense. At this point, the plaintiff no longer had the burden to show that fraudulent behavior had occurred, but only to show that Mr. Perelman had relied on the Sunbeam/Morgan Stanley lies and had suffered damage as a result of that reliance. While important battles had clearly been won, the war was hardly over. Proving that Ronald Perelman, a hugely successful investor, with a large and sophisticated team of business advisors of his own, placed any reliance on Sunbeam and Morgan's statements in deciding to enter

into a $1.5 billion deal would prove to be a daunting task. Mr. Scarola spent four hours in opening statement to lay the complex foundation for the case, which took almost two months to try despite the fact that the issues had been substantially narrowed.

Morgan's next response was an attempt to have Judge Maass removed from the case, arguing that her "bias, antagonism, and hostility" toward the company undermined the integrity of the court and the ability of the defendant to obtain a fair trial. Morgan's motion was denied twice – first by Judge Maass herself and then by the appellate court, which acted in support of Judge Maass with extraordinary swiftness. The appeal was denied within hours of the appellate court's receipt of Morgan's papers. Morgan then sought a mistrial by alleging jury tampering, one of dozens of unsuccessful mistrial motions that peppered the trial proceedings. Morgan completely underestimated the judge's determination to conduct a fair and equitable trial, and the jury's ability to comprehend the massive scope and complexity of Morgan's fraud. On May 16, the jury awarded Mr. Perelman $604 million in compensatory damages for having relied on Morgan's misrepresentations about Sunbeam's finances. The second phase, to determine both entitlement and amount of punitive damages, started immediately.

Two days later, the jury awarded Mr. Perelman $850 million in punitive damages. The two jury awards totaled $1.45 billion. On June 23rd, the trial judge added interest owed by Morgan Stanley to Mr. Perelman. The judgment now totals $1.58 billion. That amount sends a message to businesses like Morgan Stanley that transparency is the order of the day, that honesty is essential in business transactions and in litigation, and that deception will not be tolerated. Morgan said it plans to appeal the verdict.

Jack Scarola stated in an interview following the trial that Judge Maass is an extremely bright, scrupulously fair, and well-respected judge who is very rarely reversed at the appellate level. She carefully documented the basis of every one of her rulings and acted well within the bounds of established precedent. "We are extremely confident that this is a record that is going to withstand the most rigorous appellate review," Scarola said.

The after-shocks of the verdict are significant. Lawyers representing Mr. Perelman's company, Coleman (Parent) Holdings, Inc., intend to pursue contempt sanctions against Morgan, including millions of dollars in attorneys' fees and costs expended in establishing the bank's willful violation of court orders. Mr. Perelman's counsel has received numerous inquiries from lawyers throughout the

United States seeking information on behalf of their clients who are investors with serious questions of their own regarding Morgan Stanley's business practices. Federal regulatory and enforcement agencies have focused attention on the disclosures made in this case concerning Morgan Stanley's activities. Morgan's stock price has reacted to the bad news, and its current CEO, Philip Purcell, recently announced his resignation following the earlier departure of numerous high-ranking Morgan Stanley executives. The very future of Morgan Stanley, a Wall Street giant, is in question.

Morgan's Goliath may not be dead, but Ronald Perelman has certainly brought this Goliath to its knees. ■