

Zimmer Biomet Says Fatal Flaws Doom \$3B Del. Cashout Suit

By Jeff Montgomery

Law360 (June 15, 2021, 7:43 PM EDT) -- Attorneys for Zimmer Biomet Holdings Inc. directors and investors attacked as "not plausible" Tuesday a Delaware Chancery Court stockholder suit seeking damages for allegedly undisclosed company woes that led to a stock plunge while private equity investors safely cashed out billions.

During dismissal arguments before Vice Chancellor Lori W. Will, Laura Hughes McNally of Morgan Lewis Bockius LLP, counsel to ZBH and 13 current or former officers and directors, told the court that, the suit failed to show the board was too conflicted to take up the derivative damage claims before stockholders stepped in to seek damages for the company.

In addition, McNalley said, the 152-page consolidated complaint failed to show that two directors with ties to private equity investors tipped the private equity firms off to negative developments, or that the private equity interests exerted control over their board designates.

"There are no facts suggesting that the board knew the private equity funds were engaging in insider trading," McNally said, noting that the majority of the board did not sell stock after problems developed. "Why would they file false statements, opening themselves up to liability. It does not make sense."

Much of the suit focused on compliance issues and company disclosure failures at a key Indiana plant site where strong growth had been projected after a \$13.4 billion, mid-2015 merger between Zimmer Holdings and medical device maker Biomet Inc.

At issue are stockholder claims that ZBH's former and current directors and officers failed to disclose manufacturing quality and control problems at the Indiana site despite internal audits after the U.S. Food and Drug Administration turned up "systemic" issues at other ZBH sites in the spring of 2016.

When the FDA began inspecting a crucial portion of ZBH's Indiana campus in September 2016, the agency immediately found deficiencies that led it to shut the factory down, devastating third-quarter revenue results.

"We're looking at a systemic violation of FDA regulations. This is a core business of the company, and the threat of a lockdown or a product-hold is going to impact the company's business," Richard A. Speirs of Cohen Milstein Sellers & Toll PLLC told the vice chancellor.

Speirs added that "What the defendants are arguing here is, a bad result, inspections by the FDA since

September 2015, does not equal bad faith. Our point is just the opposite," Speirs said. "It was their disloyal conduct and concealing of serious FDA compliance problems at the facility that led Zimmer to violate legal obligations for a year, leading to bad faith and that leads to a bad result."

Vice Chancellor Will asked McNally if it would be a fair inference that the board could have foreseen financial impacts on the company if they received information about a critical audit and problems, as alleged, in May.

"The entire point of this presentation to the board, it goes on for 30 minutes all about the FDA quality system issues the board is looking into, yet there is no tie to financial performance," McNally said. She added later that the single relevant slide displayed during the presentation "was not elevating anything in the board's mind regarding the severity of the issue."

A separate federal securities class suit that focused on some of the same allegedly undisclosed problems was settled in 2020 for \$50 million in the U.S. District Court for the Northern District of Indiana.

William M. Lafferty of Morris Nichols Arsht & Tunnell LLP, counsel to private equities TPG Capital and KKR Biomet and Jeffrey K. Rhodes, who held a TPG board seat, and Michael W. Michelson, a KKR designate, said the suit failed to make supportable claims against his clients.

"The complaint fails to identify any material, non-public information that was possessed by the board, let alone information that was passed on by the board to the PE funds for their use in registered public offerings," Lafferty said. "These were not clandestine, back-room, smoke filled insider trades as the plaintiff would have you believe. These were part of a public, long planned registered offering" by the public equities.

Two other private equity investors, affiliates of Blackstone and Goldman Sachs, are also named in the case.

Willem F. Jonckheer of Schubert Jonckheer & Kolbe LLP, counsel to the stockholders, told Vice Chancellor Will that the complaint made an "entirely reasonable inference" that Michelson and Rhodes knew about concerns at the Indiana plant and their implications.

"The argument that they would not know or hadn't received the knowledge was contrary to their purpose as directors," Jonckheer told the vice chancellor adding later: "Yet, on the heels of learning the information no later than May 3, [2016], KKR and TPG funds affiliated with Michelson and Rhodes sold billions of stock in June and August. We believe that's more than sufficient" to assert insider trading claims.

Vice Chancellor Will said she would take the arguments under advisement.

The class is represented by P. Bradford deLeeuw of deLeeuw Law LLC, Ricard A. Speirs and Christopher Lometti of Cohen Milstein Sellers & Toll PLLC, Robert C. Schubert and Willem F. Jonckheer of Schubert Jonckheer & Kolbe LLP, and Kip B. Shuman, Rusty E. Glenn and Brett D. Stecker of Shuman Glenn & Stecker.

Zimmer Biomet Holdings Inc. and the current and former officers and directors are represented by John C. Barillare, Troy S. Brown and Laura Hughes McNally of Morgan Lewis & Bockius LLP.

KKR Biomet LLC, TPG Partners, et al., Michael W. Michelson and Jeffrey K. Rhodes are represented by William M. Lafferty, Ryan D. Stottmann and Sabrina M. Hendershot of Morris Nichols Arsht & Tunnell LLP, Peter E. Kazanoff, Sara A. Ricciardi and Courtney G. Skarupski of Simpson Thacher & Bartlett LLP and Daniel V. Mccaughey, Erin Macgowan and Christian Reigstad of Ropes & Gray LLP.

The Goldman Sachs private equity affiliates are represented by Kevin G. Abrams and J. Peter Shindel Jr. of Abrams & Baylis LLP and Paul Vizcarrondo and John F. Lynch of Wachtell Lipton Rosen & Katz.

The Blackstone Capital Partners private equity affiliates are represented by Daniel A. Mason, Matthew D. Tachel, Andrew J. Ehrlich and Brette Tannenbaum of Paul Weiss Rifkind Wharton & Garrison LLP.

The case is In re Zimmer Biomet Holdings Inc. Derivative Litigation, case number 2019-0455, in the Court of Chancery of the State of Delaware.

--Additional reporting by Rose Krebs, Emilie Ruscoe and Reenat Sinay. Editing by Amy Rowe.

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