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WSGR ALERT

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DELAWARE COURT OF CHANCERY GRANTS $1.2 BILLION DAMAGE AWARD

On October 14, 2011, the Delaware Court of Chancery issued a post-trial opinion in a derivative action that challenged Southern Peru Copper Corporation's acquisition of Minera Mexico, S.A. de C.V., from Southern Peru's own controlling shareholder. The court found that defendants failed to meet their burden under the "entire fairness" standard of review and awarded $1.263 billion in damages.[1] We believe this to be the largest single monetary award in Chancery Court history.

Background

At the time of the acquisition, Grupo Mexico, S.A.B. de C.V., was a controlling shareholder of Southern Peru, a NYSE-listed mining company. Grupo Mexico controlled 54.17 percent of Southern Peru's outstanding capital stock, which represented 63.08 percent of Southern Peru's voting power. Grupo Mexico also controlled 99.15 percent of Minera, a Mexican mining company. In February 2004, Grupo Mexico proposed to Southern Peru's board that it acquire Grupo Mexico's interest in Minera for 72.3 million shares of Southern Peru stock, which represented an equity value of approximately $3.05 billion in market value at that time.

In response to the proposal, Southern Peru's board formed a four-member special committee, tasked it with evaluating the acquisition, and authorized it to retain legal and financial advisors as it deemed fit. The special committee members were highly sophisticated, prominent individuals experienced in M&A transactions, including an M&A lawyer, a consultant for various financial institutions, a former manager of multibillion-dollar companies, and a former official of the Mexican government. The plaintiffs did not challenge the independence of these members. The special committee also retained nationally recognized U.S. counsel and financial advisors, as well as a mining expert and Mexican counsel.

At the beginning of the process, the special committee's financial advisors engaged in a "give/get" analysis, which valued the "give" at $3.1 billion based on Southern Peru's market price and the "get" at no more than $1.7 billion. The special committee's advisors, however, abandoned this approach for what one special committee member described as an "apples to apples" comparison, or relative valuation analysis. Through this process, the special committee's financial advisors valued Minera at $2.085 billion using adjusted Minera management projections and the most aggressive assumptions.

Armed with its new valuations, the special committee countered with 52 million shares of Southern Peru stock (at a fixed exchange ratio) representing $2.095 billion—a fact that was not included in the proxy statement. Grupo Mexico rejected the offer and proposed 67 million shares, representing $3.062 billion. The special committee responded with a new proposal of 64 million shares representing $2.95 billion, plus (1) a 20 percent collar around the purchase price, (2) a majority of the minority voting provision, and (3) a $1.105 billion cap on Minera's debt.

The final deal negotiated by the special committee included the following terms: (1) 67.2 million shares of Southern Peru's stock, representing $3.08 billion at the time (which increased to $3.672 billion as of the merger date); (2) a $1 billion cap on Minera's debt; (3) a $100 million special dividend paid as part of the closing; (4) "post-closure corporate governance changes at Southern Peru designed to protect minority stockholders, including a requirement for review of related-party transactions"; (5) a super-majority vote for merger approval; and (6) a fixed exchange ratio.

Court of Chancery's Conclusions

The court agreed with the parties that the appropriate standard of review where a controlling shareholder stands on both sides of the transaction is entire fairness, which requires a showing of fair process and fair price despite the existence of the special committee. The more important of the two, the court noted, is fair price. The question thus became whether the defendants successfully had shifted the burden of persuasion to the plaintiffs based on the existence of a special committee and a super-majority vote. The court held that the defendants had not successfully shifted the burden of persuasion because (1) the special committee was not "well-functioning," as is

[1] *In re S. Peru Copper Corp. S'holder Derivative Litig.*, C.A. No. 961-CS (Oct. 14, 2011).

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required under *Kahn v. Tremont Corp.*, 694 A.2d 422 (Del. 1997); and (2) the merger vote was not "conditioned up-front on the approval of a majority of the disinterested stockholders," nor was it fully informed, as the proxy statement omitted material information regarding negotiations between the special committee and Grupo Mexico, as well as the financial advisors' valuation.

The court then held that the merger process was not fair and did not result in a fair price for the following reasons, among others:

- The special committee's mandate was narrow, and although the special committee did go further and negotiate, it did not examine any other alternatives that might have "generated a real market check," all of which "deprived the Special Committee of negotiating leverage to extract better terms."

- One of the special committee members was not "well-incentivized" to engage in hard negotiations because he was working with Grupo Mexico on a deal that would provide liquidity for his stockholding employer. Although the court held that this special committee member did not act in bad faith, it noted that he was not the "ideal candidate to serve as the 'defender of interest of minority shareholder.'"

- Rather than using the leverage that Southern Peru had in its proven market value to force Grupo Mexico to justify why Southern Peru should pay $3.1 billion for Minera, the special committee and its financial advisors discounted Southern Peru's market price, implemented the relative valuation analysis, and optimized inputs to make Minera a more attractive target, but it failed to do the same for Southern Peru.

- Despite the fact that the special committee retained the right to change its recommendation in favor of the merger, it failed to update its fairness analysis before the merger vote although Southern Peru had greatly outperformed the projections on which the deal was based while Minera had not.

The court found no comfort in the deal concessions that the special committee extracted, describing them as "weak" and incapable of closing the fairness gap.

In determining damages, the court crafted an award that represented the difference between the price at which the special committee would have approved the acquisition had the process been entirely fair ($2.409 based on a discounted cash-flow value, the market value of the special committee's 52 million share counteroffer as of July 2004, and a comparable companies analysis) and the price that the special committee actually agreed to pay ($3.672 billion as of the merger date). The remedy amounted to $1.263 billion, which the court held that Grupo Mexico could satisfy by returning the appropriate number of shares to Southern Peru.[2]

Implications

This opinion is yet another reminder that in the context of controlling shareholder transactions, entire fairness remains the appropriate standard of review. The court will scrutinize closely the actions of the controlling shareholder, the board (including any committee thereof), and the work of its advisors in determining whether a transaction was entirely fair. The opinion further makes clear the potential benefits of conditioning transactions involving a controlling shareholder on various protective procedural devices. Finally, the case highlights the potential risks if this type of transaction is not structured correctly, and it shows the Chancery Court's willingness to impose substantial monetary damages to remedy any perceived wrongs.

For more information on this decision or any related matters, please contact your regular attorney or any member of Wilson Sonsini Goodrich & Rosati's securities litigation practice.

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[2] Additionally, the court held that the defendants must add interest to the $1.263 billion award at the statutory rate (5 percent above the Federal Reserve discount rate) from the merger date, without compounding, which will significantly increase the award amount given the April 1, 2005, merger date.