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Delaware Supreme Court Affirms $2 Billion Judgment

The Delaware Supreme Court recently affirmed a $2 billion judgment by the Court of Chancery in the Grupo Mexico/Southern Copper shareholder derivative litigation. The court also affirmed Chancellor Leo Strine Jr.'s award of more than $300 million in attorney fees in a case that is sure to attract attention from lawyers on both sides of mergers and acquisitions litigation. The court unanimously denied reargument of the fee award on September 21, 2012.

The litigation rose from Southern Copper's (then Southern Peru) acquisition of Minera Mexico. Southern Copper, a mining company listed on the New York Stock Exchange, received a proposal from its majority stockholder, Grupo Mexico, S.A.B. de C.V., under which Southern Copper would acquire Grupo Mexico's 99.15 percent interest in Minera—a non-publicly traded Mexican mining company—for $3.1 billion in Southern Copper stock. Because of Grupo Mexico's self-interest in the transaction, Southern Copper formed a special committee of disinterested directors who retained their own financial and legal advisors. According to the Delaware high court, "The Special Committee spent eight months in an awkward back and forth with Grupo Mexico over the terms of the deal before approving Southern [Copper's] acquisition of 99.15% of Minera's stock in exchange for 67.2 newly issued shares of Southern [Copper] stock."

By the time the merger closed, the value of the 67.2 million shares of Southern Copper had grown to $3.75 billion. Grupo Mexico assumed that Minera's equity was worth $3.05 billion, but the Delaware courts ruled that since Minera was almost wholly owned by Grupo Mexico, its shares had no market-tested value.

The lawsuit was then brought against the Grupo Mexico subsidiary that owned Minera, the Grupo Mexico-affiliated directors of Southern Peru, and the members of the special committee, claiming that the merger was "entirely unfair to Southern Peru and its minority shareholders." Chancellor Strine ultimately ruled that the transaction failed to meet Delaware's "entire fairness" standard for assessing transactions with controlling shareholders. The court criticized the financial advisor's "non-real world set of analyses that obscured the actual value of what Southern Peru was getting," and found that the special committee failed to consider strategic alternatives and failed to obtain a bring-down fairness opinion. The court dismissed the independent directors at summary judgment because of the exculpatory charter provision that imposes liability for bad faith only, but assessed judgment against the Group Mexico-affiliated directors who "made no effort to show that they acted in good faith and were entitled to exculpation despite their lack of independence." The court awarded $1.35 billion in damages, which award grew to $2.03 billion with pre- and post-judgment interest.

The Delaware Supreme Court's ruling highlights four key issues in derivative litigation. First, the presence of an independent special committee alone does not meet the entire fairness requirement, and even a well-qualified committee will be subject to a critical review. The special committee in the Grupo Mexico transaction was well structured; committee members were "competent, well-qualified individuals with business experience"; the committee had been "given the resources to hire outside advisors"; and the committee had hired "top tier of the market financial and legal counsel." But the Delaware Supreme Court held that the committee members had a "controlled mindset" such that the committee was not well functioning.

Second, exculpatory provisions will shield independent directors, but liability of interested directors who have not shown "good faith" will "rise or fall with the issue of fairness." The Delaware Supreme Court affirmed the court's dismissal of the claims against the independent special committee members, agreeing that the exculpatory charter provision shielded them from liability where there was no breach of the duty of loyalty. Judgment against the non-independent directors was affirmed.

Third, the court has substantial discretion in awarding damages and attorney fees. Despite the jaw-dropping size of the judgment, the Delaware Supreme Court found no error in Chancellor Strine's "transparent" analysis of damages. Moreover, it found no error in an award of attorney fees that amounted to 15 percent of the $2 billion judgment—an award of more than $35,000 per hour worked. In affirming its 32-year-old decision in *Sugarland Industries, Inc. v. Thomas*, 420 A.2d 142 (Del. 1980), the court rejected the Third Circuit's "lodestar" method and noted that the vast majority of courts of appeals now permit the use of the percentage of the fund method in common fund cases.

The Delaware Supreme Court reaffirmed that, under this method, state courts should consider and weigh five factors: (1) the results achieved; (2) the time and effort of counsel; (3) the complexity of the issues; (4) any contingent fee basis; and (5) counsel's standing and ability. Chancellor Strine properly applied these factors, reducing the original fee request from 22.5 percent to 15 percent in light of the extremely slow pace of prosecution, the opinion said.

Fourth, at least in the state of Delaware, courts will look to the entire judgment awarded to a corporation in a derivative suit when assessing the "benefit achieved" upon which to base a fee award. The Grupo Mexico/Southern Copper defendants asserted that the Delaware Supreme Court had not considered the impact of the judgment on minority shareholders, arguing that Grupo Mexico will essentially pay itself, since it owns 81 percent of Southern Copper, and accordingly, the "benefit achieved" should be based only on the other 19 percent of the fees that will inure to Southern Copper. The high court denied the motion for reargument on waiver grounds and summarily rejected defendants' "look through" approach to attorney fees, reminding defendants that a derivative suit is brought nominally on behalf of a corporation, and any recovery must therefore go to that corporation. No stockholders—even a majority stockholder—have a claim to particular assets of the corporation.

The Delaware Supreme Court's affirmation of the record damages and fee award could have lingering implications for derivative litigation. The decision serves as a continued warning to special committees evaluating related party transactions: The litigation risks of such transactions can be monumental.

The cases are *Americas Mining Corp. v. Theriault*, *Southern Copper Corp. v. Theriault*, Nos. 29, 30, 2012 (Del. S. Ct. Sept. 21, 2012).

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