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Delaware Supreme Court Upholds Court of Chancery's Award of $2 Billion in Damages and $300 Million in Attorneys' Fees in a Controlling Stockholder Transaction that Failed Entire Fairness Review

In the recent decision Americas Mining Corp. v. Theriault, the Delaware Supreme Court affirmed the Delaware Court of Chancery's October 2011 decision In re Southern Peru Copper Corporation Shareholder Derivative Litigation; in the lower court decision, the Court of Chancery held that a controlling shareholder and its affiliated directors breached their duties of loyalty because the process by which a transaction with that controlling stockholder was negotiated and approved was not fair and did not result in the payment of a fair price. In upholding the decision, the Supreme Court determined that the Court of Chancery's entire fairness analysis was comprehensive and that its conclusions, including with respect to the awarded damages and attorneys' fees, were the product of an orderly and logical process well supported by the record. These decisions emphasize, among other things, the critical importance of a properly formed and effectively functioning special committee in an interested party transaction.

Background

This case arose out of the April 2005 acquisition by Southern Peru Copper Corporation, a NYSE-listed mining company ("Southern Peru") controlled by Grupo México, S.A.B. de C.V. ("Grupo Mexico"), of Grupo Mexico's 99.15% stake in Minera México, S.A. de C.V. ("Minera"), a privately held Mexican mining company, in exchange for approximately $3.1 billion of shares of Southern Peru. A special committee (the "Special Committee") of the board of directors of Southern Peru approved the transaction and recommended it to Southern Peru's stockholders. The plaintiff brought a derivative suit challenging the transaction. The Court of Chancery applied an entire fairness standard of review and held that the transaction was unfair and that Grupo Mexico and its affiliated directors breached their duties of loyalty. It consequently awarded plaintiffs damages (including interest) of approximately $2 billion and $300 million in attorneys' fees.[1]

Grupo Mexico and its affiliated directors appealed the decision, arguing, among other things, that the Court of Chancery (i) erred in not making a pre-trial determination of which party bore the burden of proof and further erred by allocating the burden to the defendants to prove that the transaction was entirely fair, despite the appointment of a special committee, (ii) was arbitrary and capricious in its determination about the "fair" price for the transaction and (iii) awarded damages that were not supported by the record.

Analysis

The Supreme Court rejected the defendants' arguments and upheld the Chancery Court's decision for a number of reasons, including the following:

- **Burden of Proof**: Although the Supreme Court acknowledged that Delaware case law permitted defendants to shift the burden of proof by showing that the transaction was approved by a well-functioning committee of independent directors, it agreed with the Court of Chancery's determination that burden shifting is a factually intensive inquiry "because it is 'deeply enmeshed' in the ultimate fairness analysis." The Supreme Court noted that in this case, not only was the pre-trial record insufficient to determine the question of burden shifting prior to trial, but "the evidence of unfairness was so overwhelming" that nothing in the record indicated that the outcome of the case would have been different if the burden had been shifted to the plaintiffs. The Supreme Court also held prospectively that unless the record permits a pretrial determination that the defendants are entitled to a burden shift, the burden to demonstrate the entire fairness of the transaction will remain with the defendants throughout the trial.

  The Supreme Court also rejected the defendants' argument that the appointment of the Special Committee should have led the Court of Chancery to shift the burden of proof to the plaintiffs and that by not doing so the Court of Chancery's decision would discourage boards from forming special committees. The Supreme Court found that the Court of Chancery followed appropriate procedure by analyzing the substance of the Special Committee's role in negotiating the transaction with the controlling stockholder to determine whether it was well-functioning. The Supreme Court also pointed out that irrespective of who holds the burden of proof, such independent committees remain critical to a defendant's arguments that a transaction reflected a fair process.

- **Entire Fairness**: The defendants argued that the Court of Chancery's rejection of the defendants' "relative value" financial analysis was without evidentiary basis and caused the Court of Chancery to incorrectly conclude that the purchase price was unfair. The Supreme Court noted that while the entire fairness standard has two components –

[1] For additional information regarding the background of this case and the Court of Chancery's findings, please see our previous Client Alert dated October 24, 2011 at http://www.shearman.com/MA-Alert-Delaware-Chancery-Court-Awards-Damages-of-1263-Billion-in-a-Controlling-Stockholder-Transaction-that-Failed-Entire-Fairness-Review-10-24-2011/

fair price and fair dealing – the "paramount consideration is whether the price was a fair one." Like the Court of Chancery, the Supreme Court found that in this case the issues of fair price and fair dealing were so intertwined that one should not separate the analysis. It further found that the Court of Chancery's criticism of the relative value methodology relied upon by the Special Committee and its financial advisor was "simply a continuation of its criticism about how the Special Committee operated". In upholding the Court of Chancery's decision that the price was unfair, the Supreme Court noted that the Court of Chancery had carefully "applied a 'disciplined balancing test' taking into account all relevant factors" and that the record supported both its factual findings and its conclusions, which were the product of an orderly and logical process.

- **Damages**: The defendants argued that the damages award was the byproduct of speculation and conjecture, not evidence in the record. Here again, however, the Supreme Court stated that the Court of Chancery was within its discretion to craft a damages award equaling an amount that "approximates the difference between the price that the Special Committee would have approved had the transaction been entirely fair" and the actual price of the transaction. The defendants also argued that the attorneys' fee award – approximately $305 million – was an abuse of discretion, but the Supreme Court upheld this decision as well, noting that regardless of the size of the award, the Court of Chancery properly exercised its discretionary authority based upon the application of settled Delaware case law to the circumstances of the case.

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