LOS ANGELES
Daily Journal
www.dailyjournal.com

THURSDAY, JANUARY 22, 2015

TRANSACTIONS

Twist on merger litigation: paid too much?

By Amy S. Park and Richard S. Horvath Jr.

Shareholder lawsuits challenging merger transactions are all too familiar. The latest development in this corporate world epidemic came last week with the recently announced settlement of *In re Freeport-McMoRan Copper & Gold Inc. Derivative Litigation, C.A.* No. 8145-VCN, pending before the Delaware Court of Chancery.

The plaintiffs in *Freeport* challenged the acquisition of McMoRan Exploration Co. and Plains Exploration & Production Co. by Freeport-McMoRan Copper & Gold Inc. But unlike most merger litigation, the plaintiffs in *Freeport* were not shareholders of the targets claiming that the deal price was too low — they were shareholders suing derivatively on behalf of the *acquirer*, Freeport, alleging that the company paid *too much* for the deal.

While the *Freeport* litigation has some uncommon and unprecedented features, the case highlights the continued focus of plaintiff firms and courts on potential conflicts in merger transactions.

Freeport is one of the largest copper, gold and molybdenum producers in the world. At the time of the merger, McMoRan was a cash-poor oil and gas exploration company. Even before the transaction, Freeport and McMoRan were intertwined. The two entities had been spun off from the same corporation in the 1990s and James Moffett, the chairman and former CEO of Freeport, was also the co-founder, co-chairman, president and CEO of McMoRan, and held a 5.3 percent stake in the entity. Plains Exploration, also an oil and gas exploration company, held a 31.3 percent ownership stake in McMoRan and, as a result, had the power to veto Freeport's acquisition.

The plaintiffs alleged that in early 2012, McMoRan was rapidly running out of cash. Plains Exploration also was threatening to exit its investment in McMoRan. The plaintiffs claimed these developments exposed Moffett and a majority of Freeport directors who owned McMoRan shares or sat on McMoRan's board to potential significant personal loss.

To save McMoRan, the plaintiffs alleged, Moffett planned a bailout by Freeport. They claimed Moffett secured Plains Exploration's support for the deal by agreeing to acquire Plains Exploration at an inflated price. They also claimed Moffett offered Plains Exploration's CEO $200 million in change-of-control payments and positions as vice-chair of the combined companies and CEO of their oil and gas business.

The plaintiffs alleged that before Moffett proposed the acquisitions to the Freeport board, he essentially pre-arranged board approval by securing the support of one director whom Moffett was certain would chair any special committee established to consider the deals. After the special committee was formed, they hired a financial adviser who, instead of protecting the interests of Freeport shareholders, allegedly worked to inflate the value placed on McMoRan and suppressed information that would diminish its value. According to the plaintiffs, Moffett improperly influenced the special committee's evaluation process and Freeport did not pursue alternative transactions.

In December 2012, Freeport, McMoRan and Plains Exploration announced that they had reached agreement on the transactions. Freeport agreed to acquire McMoRan in a transaction valued at $2.1 billion, comprised of $14.75 per share in cash, reflecting nearly an 80 percent premium to the then-trading price of McMoRan stock, and 1.15 units of a royalty trust potentially valued at $2.45 per share. Freeport agreed to purchase Plains Exploration in a transaction valued at $6.9 billion, comprised of $25 per share in cash and 0.6521 shares of Freeport for each share of Plains Exploration.

After the announcement of the transactions, Freeport's share price dropped by over 19 percent. The plaintiffs alleged Freeport's board and Moffett permitted Plains Exploration to issue a $3 special dividend totaling $390 million to Plains Exploration shareholders to secure their support. According to the plaintiffs, Freeport nonetheless paid the agreed amount for a less valuable Plains Exploration.

Freeport shareholders sued. After discovery and a hearing on a motion to dismiss, which the Court of Chancery never ruled on, the plaintiffs and the individual defendants reached a settlement, which was filed Jan. 15, 2015. As part of the settlement, Freeport has agreed to pay a special dividend of $137.5 million, minus attorney fees, to Freeport shareholders. The *Freeport* settlement will be funded by $115 million from Freeport's D&O insurance and $22.5 million from Freeport. While the settlement provides for a release of the individual defendants and Freeport's advisers and agents, the release specifically excludes the financial adviser to the special committee.

The *Freeport* settlement ranks among the largest settlements of derivative actions. Topping those ranks are the $275 million settlement in 2014 of derivative claims arising from Vivendi SA's sale of its stake in Activision Blizzard to Activision and an entity controlled by Activision's two senior officers, and the $139 million settlement in 2013 of derivative claims arising from News Corp.'s acquisition of a production company owned by the daughter of Rupert Murdoch, News Corp.'s chairman and CEO, and the alleged cover-up of illegal reporting tactics by News Corp. journalists in the United Kingdom. In both cases, the settlement proceeds were paid to the companies on whose behalf the derivative litigation was brought.

The special dividend in the *Freeport* settlement is unusual in derivative litigation and unprecedented for shareholders of an acquirer in a merger-based derivative suit. Derivative claims typically seek to redress injury suffered by a corporation arising from directors' alleged breaches of fiduciary duties. Any recovery ordinarily flows to the corporation. However, the *Freeport* litigation differs from typical derivative actions in that the shareholder plaintiffs alleged that Freeport benefited corporate insiders by overpaying for McMoRan and Plains Exploration. The settlement here should theoretically capture the amount of that overpayment discounted for the likelihood of litigation success. By providing for the distribution of the settlement proceeds directly to Freeport shareholders, the *Freeport* settlement follows the company's practice of using its cash to pay a high-yield dividend.

The *Freeport* settlement also follows a recent trend of awarding significant damages in litigation challenging transactions tainted by conflicts. In *In re Southern Peru Copper Corporation Shareholder Derivative Litigation,* 52 A.3d 761 (Del. Ch. 2011), the Delaware Court of Chancery found that Southern Peru overpaid to acquire a 99.15 percent interest in a Mexican mining corporation that was owned by Southern Peru's controlling stockholder. The court awarded $1.347 billion in damages plus pre- and post-judgment interest and $304 million in attorney fees. That award was affirmed on appeal.

The attorney fee award in Southern Peru ensures plaintiff firms will continue to scour merger transactions for potential conflicts. As Cornerstone Research reported, almost every acquisition of a public company valued at over $100 million has drawn shareholder litigation. In 2013, over 90 percent settled before deal closing. The settlements overwhelmingly obtained only additional disclosures or modified deal terms. Compared to the blockbuster fee award in *Southern Peru*, attorney fees awards for those pre-closing settlements averaged less than $1 million. Given the potential for far greater fee awards for successfully attacking a conflicted transaction, plaintiff firms are incentivized to pursue claims of director conflict, just as the plaintiffs did in *Freeport*.

The *Freeport* settlement also underscores the increasingly critical eye with which Delaware courts have viewed the actions of bankers in merger transactions in recent years. Since 2011, several financial advisers have paid heavily for their challenged conduct. Barclays Capital paid $23.7 million to settle claims for how it handled the sale of Del Monte Food Company, Goldman Sachs & Co. forfeited its $20 million advisory fee in the El Paso Corporation sale, and RBC Capital Markets LLC paid $75.8 million to resolve an attack regarding its advice in the sale of Rural/Metro Corp. That the *Freeport* settlement excluded the special committee's financial adviser from the release suggests that the adviser may soon be the target of litigation seeking a hefty pay-out.

As *Freeport* and other recent cases reflect, merger transactions will continue to come under scrutiny for potential conflicts by directors, controlling shareholders, and financial advisers. Targets and acquirers should ensure they have processes in place to neutralize such conflicts before the inevitable litigation follows upon the announcement of a deal.

Amy S. Park *is a partner and* **Richard S. Horvath Jr.** *is an associate with Skadden Arps Slate Meagher & Flom LLP & Affiliates.*

AMY S. PARK
Skadden

RICHARD HORVATH
Skadden

Reprinted with permission from the ***Daily Journal***. ©2015 Daily Journal Corporation. All rights reserved. Reprinted by ReprintPros 949-702-5390.