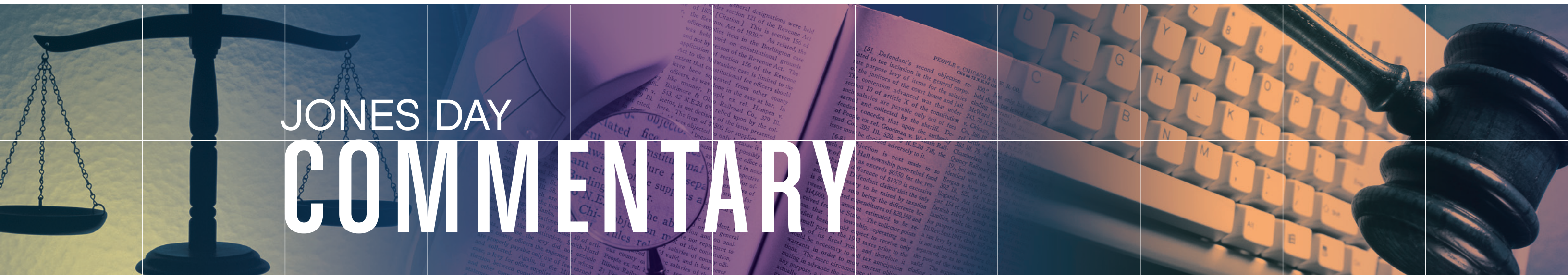

DELAWARE COURT OF CHANCERY AWARDS $1.263 BILLION IN DAMAGES FOR CONTROLLING STOCKHOLDER TRANSACTION FOUND TO BE UNFAIR

On October 14, 2011, Chancellor Leo Strine of the Delaware Court of Chancery awarded $1.263 billion to Southern Peru Copper Corp. ("Southern Peru") following trial of a derivative lawsuit against a controlling stockholder of Southern Peru and certain of its affiliates who served as directors of Southern Peru. Chancellor Strine's 105-page opinion provides important guidance for special committees in structuring and negotiating transactions with controlling stockholders.

Southern Peru was a mining company listed on the New York Stock Exchange. Grupo México, S.A.B. de C.V. ("Grupo México"), a holding company listed on the Mexican stock exchange, owned 54.17 percent of Southern Peru's outstanding capital stock and could exercise 63.08 percent of Southern Peru's voting power, and thus was Southern Peru's controlling shareholder. Grupo México also owned a 99.15 percent stake in a privately held Mexican mining company, Minera México, S.A. de C.V ("Minera").

In February 2004, Grupo México proposed that Southern Peru buy its stake in Minera for 72.3 million shares of newly issued Southern Peru stock. At the then-current market price of Southern Peru stock, this amounted to a valuation of Minera, which had no market-tested value, of $3.05 billion. Southern Peru formed a four-person special committee of disinterested directors to consider the offer, which retained a financial advisor and legal counsel. (The independence of the special committee's advisors was never called into question.) Grupo México then increased its asking price to $3.147 billion worth of Southern Peru, the exact number of shares to be determined by Southern Peru's market price at the time.

The special committee's financial advisor performed a number of valuation analyses (discounted cash flow, contribution analysis, and sum-of-the-parts), which demonstrated that the "get" (the equity value of Minera) was more than $1 billion short of the "give" (Grupo México's asking price).

The financial advisor then changed valuation metrics and performed a "relative valuation" analysis that tightened the gap between the "give" and "get" and "comforted" the special committee. The problem with this approach, noted the court, was that Southern Peru had an actual market-tested value of $3.19 billion, yet the financial advisor's new analysis gave it a "fundamental" valuation of only $2.06 billion. Thereafter, the special committee and its financial advisor "began to embrace the idea that the companies should be valued on a relative basis." Ultimately, in October 2004, the companies reached a deal by which Southern Peru would issue 67 million of its shares to Grupo México for Minera, representing a value of $3.56 billion.

After trial, Chancellor Strine concluded that the merger was unfair to Southern Peru and, as a result, the defendants breached their duty of loyalty in approving the transaction. Chancellor Strine's opinion contains several highlights of importance to special committees and their advisors:

- The court faulted the special committee for falling "victim to a controlled mindset and allow[ing] Grupo México to dictate the terms and structure of the merger." The court found that the special committee's "narrow mandate"—to "evaluate" a transaction proposed by the company's majority stockholder—and the fact that its members were uncertain whether the special committee actually was empowered to negotiate a better deal served to demonstrate their "controlled mindset" and prevented the special committee from negotiating effectively on behalf of Southern Peru.

- One special committee member's involvement served to illustrate the "controlled mindset" problem. The member in question was the board nominee of Cerro Trading Co. Inc. ("Cerro"), a shareholder that held 14.2 percent of Southern Peru's outstanding stock. Cerro wanted to divest its Southern Peru stake, which was restricted and illiquid. As part of the merger, Grupo México agreed to provide Cerro with registration rights in exchange for its agreement to vote its shares in favor of the merger if the special committee recommended it. Thus, Cerro's board nominee was not singularly focused on ensuring that Southern Peru pay the best price for Minera, and it lacked the same long-term focus that minority shareholders would be expected to have. While Chancellor Strine concluded that the director did not act in bad faith, he found that the misaligned incentives served to demonstrate how the special committee was "hemmed in by the controlling stockholder's demands" and focused "on finding a way to get the terms of the Merger structure proposed by Grupo México to make sense, rather than aggressively testing the assumption that the Merger was a good idea in the first place."

- The court found that the "onus should have been on Grupo México to prove Minera was worth $3.1 billion," but instead "the Special Committee and [its financial advisor] devalued Southern Peru and topped up the value of Minera." Rather than fairness, this demonstrated that the process was "an exercise in rationalization." The court found it significant that the special committee worked backward, performing additional discounted cash flow and other valuation analyses in order to justify paying Grupo México's asking price, which essentially remained unchanged throughout the negotiations. At bottom, there was no "give and get" between buyer and seller.

- The court found that the "relative valuation" analysis was flawed because it applied a number of assumptions to optimize, or improve, Minera's financial projections, despite Minera being in a state of financial distress, while not similarly optimizing Southern Peru's projections, despite there being evidence that Southern Peru was being valued far too conservatively. Additionally, the court found that the special committee's decision to apply Southern Peru's EBITDA multiples to Minera was "highly suspicious" given the fact that Minera was an unlisted Mexican mining operation not subject to U.S. accounting standards and SEC reporting requirements and oversight, unlike Southern Peru, a Delaware corporation listed on the New York Stock Exchange.

- The court found especially troubling the fact that the special committee discounted the stock market value of Southern Peru, which was the currency for the deal. The special committee argued that it believed the market was overvaluing Southern Peru stock, based on analyses performed by its financial advisor. The court suggested that Southern Peru could have sought to sell itself to Grupo México or say no to the deal, but instead chose “to turn the gold that it held (market-tested Southern Peru stock worth in cash its trading price) into silver (equating itself on a relative basis to a financially-strapped, non-market tested selling company), and thereby devalue its own acquisition currency.”

- The court rejected an argument raised at trial that the special committee and its financial advisor actually believed Minera was worth more than $3.1 billion because of a belief that long-term copper prices would reach $1.30. The court found that there was no evidence in the record that the special committee or its financial advisor actually held this belief, as all of the internal analyses were performed using a long-term copper price of less than $1. Moreover, even if the special committee believed $1.30 was the appropriate long-term price, it would have lifted Southern Peru’s valuation even more than that of Minera, making Minera less valuable under the “relative valuation” approach.

- The court found that several supposed concessions from Grupo México in the deal terms that the special committee cited did not justify the merger. A debt reduction commitment by Minera was more or less superfluous because Grupo México already was obligated to reduce Minera’s debt. A special dividend reduced the value of Southern Peru’s stock price, allowing the special committee to close the gap between Grupo México’s asking price of 67.2 million shares and the special committee’s 64 million share offer (and most of the dividend went to Grupo México as the majority shareholder). Many of the deal concessions actually were proposed by Grupo México, not the special committee, and one of them—a related party transaction review requirement—was put in place at a far higher dollar threshold ($10 million) than the special committee originally proposed ($500,000). A supermajority vote provision was included only after the special committee could not obtain a majority of the minority vote provision, and satisfaction of the requirement was all but guaranteed, because the vote of either of two large shareholders, each of whom desired liquidity and would receive registration rights as part of the merger, would have been sufficient, when combined with Grupo México’s vote, to satisfy the supermajority threshold. A fixed exchange ratio was not a favorable deal term for Southern Peru because it would provide protection only if Minera also was publicly traded and subject to market fluctuations. In this case, a rising market only lifted the consideration Grupo México would receive, something that turned out to be “hugely disadvantageous to Southern Peru.”

- The court faulted the special committee for failing to update its fairness analysis in the face of strong evidence that the basis for its decision had changed. Southern Peru had surpassed its EBITDA projections for 2004, and its stock price had steadily risen even though it had agreed to pay Grupo México a fixed exchange rate. This also suggested that reliance on the same 2005 EBITDA estimates was unreasonable and should have been revisited, particularly since the shareholder vote occurred on March 28, 2005, when the first quarter was almost over, a quarter in which Southern Peru made more than 52 percent of the EBITDA its financial advisor estimated it would make for the entire year.

Chancellor Strine’s opinion serves as a straightforward reminder that the Delaware courts will carefully examine the actions of a special committee tasked with negotiating a transaction with a controlling stockholder. The process of negotiating a deal must involve more than figuring out a way to justify a price offered by the controlling stockholder. In this case, the court found that engaging in a “give and get” with the controlling stockholder should have been a part of the negotiating process.

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