

# Dark, Lonely, Dangerous Work: *Mirant* Settlement Illustrates Litigation Risk

*Anthony M. Sabino*

Normally in this space, this writer reports on some new legal precedent, and its impact upon the energy industry. But not every case of note actually goes to trial, and that lack of a judicial result does not necessarily make it less instructive. With that in mind, we revisit some familiar territory: the now-concluded bankruptcy of energy provider Mirant—more precisely, its litigation against its one-time parent, The Southern Company.<sup>1</sup>

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### **SUIT HAD CONTENDED THAT MIRANT WAS TOO BURDENED TO SURVIVE**

In that article, we reported on Mirant's lawsuit, alleging violations of "fraudulent conveyance" law. The suit contended, among other things, that the parent Southern had left its one-time subsidiary with insufficient capital and an overage of debt, both so extreme that Mirant could not survive as an independent company. A trust, constructed to benefit Mirant's creditor body, had brought the action pursuant to Section 548 of the Bank-

ruptcy Code, a statute that represents the most modern iteration of centuries-old laws that prohibit the diversion of assets that could be used to pay creditors in the event of an insolvency case. Today, we find fraudulent conveyances where less than market value is given over in an asset exchange, debt is assumed with a countervailing receipt of value, and similar unbalanced corporate shenanigans.

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The creditor trust was seeking over \$2 billion in damages from Southern (even in today's jaded world of bailouts and TARP funds, we can agree that \$2 billion is "real" money). In making its charges, the trust contended that before the spinoff, Southern forced Mirant to pay its parent over half a billion dollars in dividends (all done on borrowed money), imposed draconian conditions for Mirant's newfound independence, and otherwise set it free hobbled beyond the ability to survive.

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Southern, as could be expected, denied the allegations vigorously and devoted much of its

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proffered defense to blaming Mirant's fall into bankruptcy on post-9/11 conditions, a bad economy, and the collapse of the energy trading market, as precipitated by the Enron scandal—inarguably real events, and equally inarguably contributing at least somewhat to Mirant's Chapter 11 filing.

There [might have been] an illustrative legal decision (or two!) that would clarify the body of fraudulent conveyance law as it applied to energy industry players. But that was not to be. . . . The parties settled the case.

In that prior article we promised to keep you informed, our thought back then being that there would be an illustrative legal decision (or two!) that would clarify the body of fraudulent conveyance law as it applied to energy industry players. But that was not to be. After what we can only presume was some extensive (and no doubt expensive) pretrial discovery, the parties settled the case.

### THE LOGIC OF SETTLING FOR 10 PERCENT

Mirant or, better said, the “new” Mirant, having reorganized and exited Chapter 11 in January 2006, filed a Form 8-K (a routine SEC disclosure form for making a public record of material events) that relates these few facts. On March 31, Southern agreed to settle the case by paying the sum of \$202 million to the Mirant creditors' trust. The litigation, pending in the federal Northern District of Georgia, was fully resolved without further relief.

Of the \$202 million settlement amount, some \$51 million will be distributed to the new Mirant to reimburse it for monies advanced to the trust. The remainder will stay with the trust, ultimately to be distributed to Mirant's creditors at some later date. The Mirant 8-K is generally available at Yahoo! Finance.com, and the Securities and Exchange Commission's (SEC's) EDGAR database; Southern's own SEC disclosures, similarly available to the public, mirror the Mirant disclosure. Given that litigation in U.S. courts is largely a private matter (unless you are Jon and Kate, of course),

precious little else is known about how the parties reached this accord.

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But, as we said at the outset of this article, even a case settled out of court can offer some cogent lessons. *Mirant v. Southern* is one such case. Let us start with a very fundamental, but basic lesson: you can sue for whatever amount you want, but it does not mean you are going to get it. The flip side, of course, is you can be sued for any outlandish amount the opponent can think up, but it does not mean they will get anywhere close to it, via a settlement or even a trial.

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There is no science here, just art and a heaping dose of luck, but the point to be taken is the creditors sued for \$2 billion in damages. Essentially, they took the half billion in dividends (the new debt assumed in the spinoff), calculated some economic cost to the transaction, and most likely added in punitive damages.

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Even conservative plaintiffs routinely come up with damage claims at the upper range of conceivable liability. Thus, for would-be plaintiffs, the rule of thumb is to allege as much as one reasonably can estimate as to damages suffered. But do not build a strategic business plan on recovering anywhere near that sum, because it is pure speculation as to whether you can settle for or be awarded that amount.

Conversely, CEOs need not faint away when they see a major complaint for the first time. Even astronomical sums can, with reasonably

viable defenses available of course, be whittled down in settlement talks or in a judicial award. Each side has work to do: prove and disprove the amount claimed, respectively.

### **BASIS OF SUIT SHOWS NEED FOR DUE DILIGENCE, OUTSIDE OPINIONS**

Next, let us turn to something more substantive: here, the fraudulent conveyance charges. Because there was no decision on the merits, it would be wrong to draw conclusions. But we can still glean lessons as to proper procedure. In any corporate transaction, but particularly mergers and acquisitions, appropriate valuations are key. This requires several things: disinterested and neutral outside professionals providing well-thought-out and rational evaluations; adequate (better said—more than merely adequate) due diligence, not just by the experts, but also by the relevant management and board committees that will review the transaction; and, finally, a well-informed, fully prepared, and engaged board of directors making the final decision.

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Remember, the trust here alleged Southern took out too much in dividends. If someone were to face a similar charge in the future, the demonstration of expert advice, due diligence, and thoughtful and rational decision making would pretty much defuse such an allegation from the start. In obvious counterpoise, any managers or board that failed to exercise such basic steps would be left wide open to such allegations of fault, and, in all likelihood, deservedly so.

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Likewise, *Mirant v. Southern* included allegations that the parent coerced the sub into taking on too much debt as a precondition to becoming a freestanding company. Again, in fairness,

nothing was resolved because it was settled out of court. But the lesson is much as stated above, here in particular the necessity being most acute for a very thorough investigation and report by investment bankers, accountants, and the like as to the adequacy of the capitalization of the company being divested.

Corporations pay big fees to prestigious investment banks to provide “opinion letters” attesting to the “fairness” of certain corporate deals. This is why. A board whose judgment is subsequently questioned in court needs the stout shield of a professional opinion (rendered at the time of the deal, to be sure) to demonstrate that at all times it acted reasonably and left everyone in a position to continue profitable operations.

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And make no mistake, the mere existence of an opinion is not enough. Decades of corporate litigation have taught us that every step of the opinion process—the credentials of the experts opining, the underlying due diligence, the validity of the facts obtained and presumptions made, and the sensibility of the final judgment—is subject to rigorous examination in pretrial discovery, and of course on the witness stand at trial. As one instance, the involved board members must insure that they are proactive and confident that everything is being done, and done the right way. After all, these corporate decision makers have a compelling fiduciary duty to protect the interests of the shareholders, not to mention their own personal standing.

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Next, while we do not have details, we know the parties engaged in discovery, and, judging by the multibillion-dollar stakes, no doubt a great deal of it and at great expense. We have at

least one anecdote that tells us the parties were chastised in court by the presiding judge for being overly contentious during the discovery process.<sup>2</sup>

### **ALWAYS DARK, LONELY, AND DANGEROUS WORK, DISCOVERY NOW EVEN RISKIER**

Let us face facts. Discovery is disruptive (you have to suspend normal operations to pull together records), distracting (your best people have to spend time preparing for and being deposed), damaging (to your bottom line, because it costs money for lawyers and lost profits), and dangerous (sometimes the most innocuous of statements becomes a dangerous weapon in the hands of a determined adversary—not to mention the really nasty stuff that comes out).

Discovery is disruptive, distracting, damaging, and dangerous.

And today, we have “e-discovery.” No longer do we photocopy cabinets full of corporate documents; now we lay bare the totality of your database, your e-mails, everything. Is this easier because now we just hit “copy” and download all those little electrons? No, it is actually much more difficult, because e-discovery has to be so tailored and comprehensively to draw out everything that is buried in those black boxes. Moreover, it is far, far more dangerous, because you can never truly know just what is out there in the electronic wilderness (“Johnson, you said WHAT in that e-mail !!!!!”). Think about it, and you are guaranteed to lose sleep over it. And remember that is why the vast bulk of business litigation is settled without ever going to trial.

### **LOGIC OF SETTLING AT ALL COSTS**

And that brings us to our final lesson, where we draw upon this maxim (for which we claim no originality): litigation is nothing but uncertainty; settlement replaces that uncertainty with unshakeable certainty and finality. It is obvious but it has to be said. Litigation can go any way, any time. It is all about risk. Businesses and business decision makers spend pretty much all

day every day managing risk. Litigation risk is just one of them.

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As an important aside, the power to settle is largely in the hands of the parties, with little or no court interference. It is well-settled law, especially in bankruptcy cases, that the bankruptcy judge is not there to “second-guess” the efficacy of a proposed settlement. Rather, the desirability of settlement on the terms offered is left almost exclusively to the discretion of the parties.

The sole and rather simplistic test that the court applies is that the settlement does not go far below the lowest range of reasonableness. In plain English, unless an opponent to the proposed settlement can make a convincing showing that the settlement terms are absurd, the bankruptcy judge will approve the settlement after only a brief presentation. In point of fact, this is largely true in nonbankruptcy cases as well. The simple truth is if you want to settle, and can agree to terms, no one will stop you.

On the road to trial, anything can happen (and usually does).

Therefore, it can be heartily said that settlement, assuming it is on reasonable terms, provides the singular benefit of erasing uncertainty once and for all, and replacing it with absolute certainty and finality of result. On the road to trial, anything can happen (and usually does). Once a case is settled, it is done and gone forever. The parties in *Mirant v. Southern* clearly took that lesson to heart. ☐

### **NOTES**

1. Sabino, A. M. (2005, October). Another chapter in the crash of the independent generators. *Natural Gas & Electricity*, pp. 12–15.
2. Conley, J. L. (2008, January 24). Judge in *Mirant* case compares Jones Day arguments to Woody Allen joke. Retrieved August 3, 2009, from <http://www.law.com/jsp/law/LawArticle.jsp?id=900005559757>.