

From a Collection of Articles on Credit Crisis Litigation

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Bad Economic Vibe Means More Securities Litigation?

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In flush times, the balm from the boom economy covers a multitude of sins. But when the economy sours, even transactions that once appeared favorable can turn bad. When they do, lawsuits can, and usually do, arise. Two recently filed securities class action lawsuits illustrate this point and also suggest that adverse economic circumstances may fuel even further litigation.

The first of these two recent lawsuits involves [FCStone Group](#). FCStone is “an integrated commodity risk management company providing risk management consulting and transaction execution services to commercial commodity intermediaries, end users and producers.” Basically, it helps those involved in commodities business to manage their exposure to commodities price fluctuations.

Plaintiffs filed a purported securities class action lawsuit against FC Stone and certain of its directors and offices in the Western District of Missouri on July 15, 2008. The plaintiffs’ counsel’s July 16, 2008 press release describing the lawsuit can be found [here](#) and the complaint can be found [here](#).

According to the complaint, the lawsuit relates to “a misdescription of an important hedge instrument purchased by the Company.” According to the complaint, the hedge transaction provided net income to the company for the first two fiscal quarters of 2008, ending on February 29, 2008. The press release describing the lawsuit states:

In an conference call on April 10, 2008, the Company concealed the true nature of the Hedge, by failing to reveal that should there develop a significant spread between the U.S. based Fed Funds interest rate (the “Feds Funds Rate”) and the London Inter-Bank Rate (“LIBOR”), the Hedge would decline in notional value. Based on what the market was told, the investing public viewed the hedge as simply one to protect the Company from falling interest rates, and not one which was crucially dependent upon the spread between the Fed Funds Rate and LIBOR not widening.

The complaint alleges that in the company’s 2008 third fiscal quarter, a spread arose between the Fed Funds Rate and LIBOR and the company’s gains for the first two fiscal quarters were eliminated. The press release describing the lawsuit states:

On July 10, 2008, FCStone shocked the market by announcing third quarter earnings per share of 28 cents versus the expected 47 cents. Much of the deviation was due to the decline and sale of the Hedge. In addition, the Company announced previously unmentioned and significant bad debt expenses due to volatility in the cotton markets which had occurred in March. Nothing was said about this volatility and its adverse effects on the April 10, 2008 conference call. Upon revelation of this adverse news FCStone shares dropped over 41% wiping out over \$300 million in shareholder value.

The second of the two lawsuits was filed in the Southern District of New York on July 17, 2008 based on the failure of [Hexion Specialty Chemicals](#) to follow through on its planned acquisition of [Huntsman Corporation](#).

The Huntsman lawsuit arises out of the agreement announced on July 12, 2007 ([here](#)), that Hexion would acquire the company in a transaction valued at \$10.6 billion. According to the original press release, Hexion is a portfolio company of Apollo Management. . The sale was approved by Huntsman's shareholders on October 16, 2007 ([here](#)). On January 26, 2008, Hexion exercised its rights to extend the termination date of the merger agreement ([here](#)), to obtain regulatory approvals, and further extended the date in April 2008 ([here](#)). In its May 14, 2008 earnings release ([here](#)), Hexion provided a "transaction update" in which it noted that the parties had agreed, pursuant to the Merger Agreement, to allow additional time in order to obtain necessary regulatory approvals.

However, on June 18, 2008, Hexion issued a press release stating that the "transaction is no longer viable" and announcing that it had initiated a lawsuit in Delaware Chancery Court to declare its rights under the merger agreement. Huntsman later announced that it had counterclaimed to enforce the merger agreement in the Delaware lawsuit ([here](#)) and separately announced ([here](#)) that it had filed its own lawsuit against Apollo and two of its partners for fraud in inducing Huntsman to terminate its prior merger agreement with a separate merger partner, by presenting the Hexion merger proposal.

On July 17, 2008, plaintiffs' lawyers, purporting to represent a class of Huntsman shareholders, filed a lawsuit in the United States District Court for the Southern District of New York against Hexion, its CEO and one of its directors. A copy of the plaintiff's counsel's July 17, 2008 press release announcing the filing can be found [here](#) and a copy of the complaint can be found [here](#).

According to the press release,

On May 14, 2008, Hexion disclosed that it agreed to allow additional time to obtain the regulatory approvals. Unbeknownst to the public, defendants had determined to abort the merger and took steps to abrogate the Merger Agreement. Defendants retained the services of Duff & Phelps to render an opinion that the combined entity lacked financial viability. On June 18, 2008, Duff sent a letter to the Board of Directors of Hexion opining that the combined company's assets would not exceed its liabilities, that it would not have the ability to pay its total debts and liabilities as they become due and that it would have an unreasonably small amount of capital. On that same date, defendants filed a complaint in the Delaware Court of Chancery, seeking abrogation of the Merger Agreement. The reaction in the marketplace was devastating to the price of Huntsman's common stock. On June 19, 2008, the first day of trading after the June 18, 2008 actions by Hexion, the market price of Huntsman common stock fell approximately \$8, or 40%, from \$20.86 to close at \$12.84, on enormous volume of approximately 43 million shares.

The complaint purports to be filed on behalf of the class of persons who purchased Huntsman shares between May 14 and June 18, 2008.

According to the complaint, Hexion started to try to back away from the agreement because the defendants “were disturbed by Huntsman’s financial results for the three quarters after the signing of the Merger Agreement as well as the state of the economic market and the global credit crunch.”

Interestingly, though the plaintiffs’ class consists of *Huntsman* shareholders, their lawsuit is filed against *Hexion* and two of its senior officials. The complaint does not allege secondary liability, but rather it alleges that the defendants violated their primary obligations under Section 10(b). Specifically, the plaintiffs allege that

Defendants failed to disclose the material facts that they had decided to abort the merger if possible and had taken affirmative steps to determine whether they could abort the merger and abrogate the Merger Agreement and retained the services of Duff to render an opinion that the combined entity lacked financial viability and Wachtell to draft and file a complaint. These material misstatements and omissions had the cause and effect of creating in the market an unrealistically positive assessment that the merger would close by July 4, 2008 ... causing the Huntsman’s common stock to be overvalued and artificially inflated during the Class Period.

The attempt by *Huntsman* shareholders to hold *Hexion* and its officials liable under the federal securities laws raises some unusual issues and will be interesting to watch. The unusual occurrence of a securities lawsuit brought by another company’s shareholders also potentially raises an interesting theoretical issue depending on the definition of “Securities Claim” in Hexion’s D&O insurance policy. There are two usual variants of this definition, one of which defines the term by reference to the kind of *claims* (that is, claims under specifies securities law), and one that defines the term by reference to the kind of *claimant* (that is, by reference to claims by holders of securities of the company).

I have no direct knowledge of Hexion’s insurance program, but because so-called entity coverage under D&O policies is typically limited to “Securities Claims,” the definition of that term in the Hexion policy could determine whether or not the company itself has coverage for the claims brought against them by the Huntsman shareholders. The availability of coverage for the claims against the entity could well depend on which variant of the definition of the term “Securities Claim” appears in the Hexion policy. To the extent the term is restrict to claims brought by holders of Hexion’s own securities, coverage potentially might not be available for the company itself for the Huntsman shareholders’ lawsuit.

Perhaps the circumstances involved in these two cases might have arisen even in more stable economic times, but the troubled transactions underlying the lawsuits seem symptomatic of the currently turbulent economy. Indeed, the Huntsman shareholders lawsuit specifically alleges that among the reasons why Hexion sought to back away from the merger were “the state of the economic market and the global credit crunch.” In

both of these instances, transactions that initially appeared favorable appeared unfavorable as circumstances changed.

The challenging circumstances that undermined these transactions are hardly unique to these two companies. In all likelihood, in the weeks and months ahead, other companies will be finding that transactions entered in more clement circumstances now appear troubled. As more companies stumble on these troubled transactions, further lawsuits undoubtedly will emerge.

One final note. There is nothing about these lawsuits that make them subprime related, and it is only in the broadest sense that they lawsuits might be categorized as credit crisis related. If nothing else, these lawsuits at the outer edge of the current litigation wave demonstrate the complicated definitional problems involved with trying to track subprime and credit crisis related lawsuits. In the end, I have decided not to “count” these lawsuits in my running tally of subprime and credit crisis related litigation (which can be accessed [here](#)), because they seem to relate to much larger economic issues (such as interest rates and the adverse business climate). Reasonable minds may differ on this categorization.