

ALERTS

Tronox Securities Litigation Settlement Has Implications for Environmental Disclosures and Related D&O Insurance Claims

August 17, 2012

A settlement has been announced in the Tronox Securities Litigation,[1] making it one of the first cases where the failure to publicly disclose environmental liabilities has resulted in a substantial settlement. The plaintiffs — investors in the Tronox IPO — claimed that they were defrauded by the defendants, who allegedly orchestrated a scheme to rid the Kerr-McGee Corporation of hundreds of million of dollars and decades of environmental legacy liability by dumping all of the company's environmental liabilities into Tronox Incorporated, and then failed to adequately disclose these material liabilities to potential investors in Tronox's IPO. The \$37 million settlement is allocated between defendants Kerr-McGee, Anadarko Petroleum Corporation, Ernst & Young and certain individual directors and officers of Kerr-McGee and Tronox.[2]

Tronox Securities Litigation

The plaintiffs alleged that the defendants violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. Sec. 78j(b) and 78t(a), and Rule 10b-5 by making material misstatements and omissions in their public filings in order to defraud the public into investing in Tronox. According to the plaintiffs, defendants loaded Tronox with Kerr-McGee's legacy environmental liabilities, then materially misrepresented the magnitude of Tronox's environmental obligations so that Kerr-McGee could be acquired by defendant Anadarko for \$18 billion, free and clear of

the legacy environmental liabilities. To support their allegations, the plaintiffs cited a 2009 Form 8-K, in which Tronox admits that the 10-Qs and 10-Ks it previously filed “should no longer be relied on because the Company failed to establish adequate reserves as required by applicable accounting pronouncements” and noted that the Company had not yet completed a review of “all known sites where the company may have environmental remediation and other related liabilities” but that the “adjustments will be material.”

The plaintiffs alleged that in contrast to the approximately \$200 million listed on Tronox’s environmental remediation reserves, Tronox was actually burdened with up to \$900 million of legacy liabilities, some of which arose from Tronox’s operations, while the rest came from the operations of Kerr-McGee. The plaintiffs further alleged that defendants intentionally neglected to disclose the existence of numerous “secret sites” at which defendants were well aware there existed significant environmental legacy liabilities. The complaint alleged that, as a result of these fraudulent acts, not only did Kerr-McGee benefit as an entity, but the individual Kerr-McGee directors and officers reaped a windfall in personal profits.

The \$14 million settlement share of the Tronox individual defendants will be paid by their directors and officers (“D & O”) insurance carriers, and, it appears that at least some portion of the \$21 million share of the remaining defendants (other than Ernst & Young) will also be paid by insurance carriers. While many D&O policies have pollution exclusions, those exclusions should not preclude coverage for inadequate financial disclosures simply because the disclosures happen to be based on environmental liabilities, and many policies have carve outs to the pollution exclusion specifying that coverage for securities claims based on environmental disclosures are not excluded. Also, since D&O Policies have exclusions for claims arising out of fraudulent or intentional illegal acts, it seems likely that the policies here contain either non-imputation or final adjudication clauses, limiting the reach of the fraud exclusion. Otherwise, the plaintiffs’ claims would seem to fit squarely within the fraud exclusion and the insurers would not likely have contributed to settlement.

The Bankruptcy Litigation

Tronox, undercapitalized to fund all of its environmental liabilities, was forced to declare bankruptcy in January 2009. A trial is currently underway in the bankruptcy court, in which a Litigation Trust, pursuing claims on behalf of Tronox, is suing Anadarko and Kerr-McGee for \$25 billion in damages with respect to Tronox's environmental liabilities. Pursuant to a global settlement that allowed Tronox to emerge from bankruptcy last year, the United States Environmental Protection Agency will receive 88 percent of any damages recovered by the Litigation Trust and tort victims will share the remaining 12 percent. Like the securities plaintiffs, the Litigation Trust has alleged that Kerr-McGee orchestrated the transfer of its environmental liabilities to Tronox, and spun it off in an IPO to avoid liability for Kerr-McGee's environmental legacy liabilities. Kerr-McGee has denied that there was any fraud.

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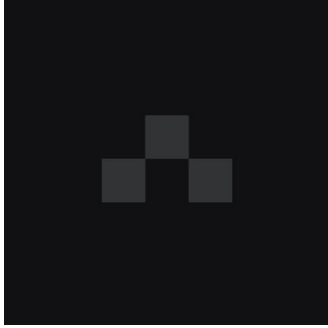
If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

[1] *In re Tronox, Inc. Securities Litigation*, Civil Action No. 09-cv-06220-SAS, in the United States District Court for the Southern District of New York.

[2] Tronox itself, which had declared bankruptcy, was not a party named to the suit.

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