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Asarco leaves legal heartburn

Owner could face \$1 billion-plus in obligations

LES BLUMENTHAL: The News Tribune
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WASHINGTON – It is one of Mexico's most low-profile companies, run by a politically connected family that is no stranger to the bare-knuckled world of international mining.

Now, Grupo Mexico S.A. de C.V. could find itself on the hook for Asarco's bankruptcy and responsible for paying off creditors of the century-old American mining and smelting company.

The stakes are enormous.

Asarco owes more than \$1 billion to clean up environmental contamination at 94 sites in 21 states, including the company's former copper smelter on the border of Tacoma and Ruston, according to court filings. In addition, more than 85,000 asbestos exposure-related claims worth an estimated \$500 million have been filed against Asarco, and more are expected.

Over the coming months, lawyers have said in court documents, they will try to convince a federal bankruptcy judge in Texas that Grupo Mexico "systematically cannibalized" Asarco since buying it six years ago and should be ordered to help cover its debts.

"They stole the piggy bank," said John Tate, a San Antonio lawyer representing asbestos claimants in the bankruptcy. "Absolutely we will go after them. They are the deep pockets."

Asarco lawyers dismiss the claims as "innuendo and speculation."

The Asarco saga, however, is about more than just the financial collapse of a once-profitable company following its unexpected takeover. It is also about more than corporate maneuvering to gain control of some of the world's most valuable copper mines high in the Andes of Peru.

The Asarco bankruptcy has exposed weaknesses in one of the nation's premier environmental programs: the Superfund.

The fund was created in 1980 to clean up the nation's legacy of toxic pollution. It was financed with a special corporate tax that expired in 1995.

The Superfund's \$3.8 billion surplus has been spent, and the program now lives off annual appropriations from Congress. Unless Congress approves another funding mechanism, taxpayers will increasingly pay for the environmental cleanups.

Asarco's bankruptcy will only add to the burden.

Some regulators fear other companies with major environmental liabilities will follow Asarco's lead and seek bankruptcy protection. A report last year from Congress' Government Accountability Office said officials in eight of the EPA's 10 regions expect more such bankruptcies.

The GAO report also said bankruptcy laws allow companies to potentially skirt their Superfund obligations, and added that the EPA is ill-equipped to deal with the situation.

EPA and Justice Department officials say they aren't worried. They have adequate staff to deal with additional bankruptcies, they say, and the law is on their side.

"The EPA and the Justice Department generally find that bankruptcy filings are rarely due to environmental liabilities," EPA spokesman Dave Ryan said in an e-mail, which was the only way he would respond to questions.

ASSURANCES ALLOWED, NOT CHECKED

Companies with Superfund responsibilities are supposed to offer financial assurances they will clean up their sites. But the GAO found that isn't always the case.

Asarco promised it would clean up the Ruston smelter site, offering a "self-assurance" to the EPA. Self-assurances are allowed if a company passes a complicated financial test that hasn't been adjusted for inflation since 1982.

The EPA's inspector general reported that one of the agency's regional offices found almost one-third of the companies with Superfund obligations were out of compliance with their financial assurances.

The 1980 Superfund law required the EPA to issue a comprehensive regulation covering financial assurances. The regulation has never been written.

The GAO, the EPA's inspector general, the EPA's Environmental Financial Assurance Board and a team of senior EPA managers have criticized EPA for not acting in 25 years. Several EPA officials said privately that it is all but impossible to write a one-size-fits-all regulation that would cover every industry, and the political pressures would be enormous if they tried.

"EPA is at a disadvantage when it comes to these corporate maneuvers," said Christine Fishkin, who wrote the GAO report. "It's not a level playing field, and the solution is tougher financial assurances."

TAKEOVER RAISED RED FLAGS

Grupo Mexico's takeover of Asarco in 1999 set off warning bells in the EPA and the Justice Department.

Asarco was considered an attractive takeover target because of its 54 percent interest in the Southern Peru Copper Co. The Peruvian company owns two mines in South America's rich copper belt and in 1999 had announced the discovery of major new reserves.

Federal regulators were concerned about Asarco's mounting environmental liabilities and a balance sheet that was steadily tipping toward insolvency. But they were powerless to stop the takeover.

Founded in the 1950s by Jorge Larrea Ortega, who was known as the "King of Copper," Grupo Mexico has a reputation as a private company. It's the third-largest copper producer in the world, controls Mexico's largest and most profitable railroad and reportedly is interested in buying Aeromexico, one of Mexico's major airlines.

Larrea died in 1999 at age 87, and the company now is run by his son, German Larrea Mota-Velasco. As major players in the international mining market, the family is considered sophisticated and shrewd. But it is a cutthroat industry.

PERU COPPER MINES CALLED KEY

In filings in the Texas bankruptcy court and in a New York case, lawyers for the asbestos claimants allege that Grupo Mexico's "bust-up" acquisition of Asarco was aimed squarely at acquiring control of the Peruvian mines.

"After less than six years of pillage by Grupo Mexico, Asarco today is a depleted, denuded vestige of a once vibrant, century old-mining enterprise," one brief said.

Within days of the takeover in November 1999, Grupo Mexico named some of its corporate officers, including Larrea, to top positions at Asarco. Grupo moved Asarco's corporate offices from New York to Phoenix, where it shared office space with another Grupo mining subsidiary, Americas Mining Corp.

Less than a month later, Asarco began selling its nonmining assets to pay for its own takeover, the asbestos lawyers claim. Asarco sold its specialty chemicals division, Enthone, for \$503 million and its aggregates division, American Limestone, for \$211 million. The proceeds from both sales were used to pay for Grupo Mexico's buyout of Asarco.

The asbestos lawyers allege the "fire sales" of Enthone and American Limestone exacerbated Asarco's financial problems and served as a prelude to Grupo Mexico's plan to acquire control of Asarco's "crown jewel": the Southern Peruvian Copper Co.

Takeovers often are financed by selling a company's assets. But it could be illegal, under certain circumstances. According to court filings in the bankruptcy case and in another case filed by asbestos lawyers against Asarco in New York, Grupo Mexico engaged in the "fraudulent conveyance" of Asarco assets to finance its takeover and to limit future Asarco's financial liabilities. Such allegations can be difficult to prove.

"It was a classic leveraged buyout carried out by the fraudulent conveyance of Asarco's assets, and they got SPCC almost for free," said Alan Rich, a Dallas lawyer representing asbestos claimants.

Grupo Mexico initially sought to purchase the Peruvian mines for \$640 million in the summer of 2002, a price tag asbestos lawyers insist was outrageously low. EPA and Justice Department lawyers, in a step believed unprecedented, secured a temporary restraining order in federal court to block the sale.

"It was a Texas Hold'em move," said an EPA regulator who would speak only on the condition of anonymity. "We knew we could make it difficult for them, but it was a bluff. There really wasn't much we could do."

CONCERNS GROW ABOUT CLEANUP

Though no two cases are the same, EPA is no stranger to bankruptcies involving companies with major Superfund obligations.

In one case, MagCorp filed for bankruptcy protection in 2001 seven months after the Justice Department filed a lawsuit seeking \$900 million in fines for toxic waste violations, according to the GAO. The bankruptcy court allowed MagCorp to sell its assets to a new company, US Magnesium, which was controlled by the same owner as MagCorp.

In another case, Gulf Resources and Chemical Corp., which potentially faced massive cleanup costs resulting from its Northern Idaho mining interests, sought bankruptcy protection in the mid-1990s after a succession of buyouts.

In Asarco's case, EPA grew increasingly anxious about whether Asarco would be able to fulfill its written assurances to clean up the Ruston smelter and other sites after the company sold its chemicals and aggregate divisions.

Asarco had approached EPA about a "global settlement" covering its environmental liabilities. With the temporary restraining order in place, government and Asarco lawyers intensified settlement negotiations.

In early 2003 they reached an agreement allowing Grupo Mexico to take control of the Peruvian mines for \$765 million, which was \$125 million more than the original purchase price. Grupo Mexico also agreed to fund a \$100 million trust dedicated to cleanups at Asarco's mining and smelting sites. EPA and the Justice Department agreed not to pursue any enforcement actions against Asarco for three years.

"EPA and the Justice Department took a pittance to roll over and go away," said Tate, the San Antonio asbestos claims lawyer. "We would like to undo the entire transaction or have them pay a reasonable amount for SPCC."

With the price of copper now at record levels, the Peruvian mines could be worth three or four times as much as they were in 2003.

In agreeing to the settlement, EPA officials said the \$100 million trust was better than nothing, considering Asarco was on the edge of bankruptcy.

"The United States believed at the time and continues to believe that the settlement was in the best interest of maximizing environmental cleanups," said Cynthia Magnuson, a Justice Department spokeswoman.

TRUST FUND might BECOME TARGET

The environmental trust fund could become part of the bankruptcy proceedings.

Asbestos lawyers won't reveal their legal plans, but EPA managers around the country said they worry the asbestos claimants might try to tap the trust fund as part of any Asarco reorganization to pay off creditors. The next annual distribution – the first since the bankruptcy filing – takes place in June.

Since the bankruptcy filing last August, the asbestos lawyers say Grupo Mexico has taken steps to force Asarco to cease operations and liquidate its remaining assets rather than reorganize, according to court documents.

Almost immediately after Asarco sought bankruptcy, its board of directors resigned. Two new board members were named, but one resigned a month later, leaving Carlos Ruiz Sacristan running the company. Ruiz also is on the board of directors of Southern Peru Copper Co. and was Mexico's minister of communications and transportation in the late 1990s when Grupo Mexico purchased its first railroad from the Mexican government.

In court documents, the asbestos lawyers accused Ruiz of prolonging a labor strike last year at the Asarco mines in Arizona, allowing Southern Peru Copper to maximize its profits and steal customers from Asarco. They said the four-month strike cost Asarco up to \$50 million.

"By reducing copper production at a 'deliberately failed' Asarco reorganization, Grupo Mexico will benefit from increased copper prices as well as increased copper profits from its other mining operations," the lawyers said in one court filing.

'WE HAVE STABILIZED THE COMPANY'

In late December, the bankruptcy judge agreed to appoint two U.S. businessmen without ties to Grupo Mexico to the Asarco board of directors.

Grupo referred questions about the bankruptcy to Asarco. Lawyers for Americas Mining Corp., Grupo Mexico's mining subsidiary that Asarco is part of, did not return repeated phone calls seeking comment.

But in court filings, Americas Mining Corp. dismissed the asbestos lawyers' latest allegations as "innuendo and speculation" that are "deafeningly silent when it comes to the facts."

For its part, Asarco could be forced to turn on its corporate parent and join the asbestos lawyers in trying to recover money from Grupo Mexico. Under the federal bankruptcy code, Asarco's "fiduciary responsibilities" now are to its creditors rather than its stockholders. The company might have no choice but to go after Grupo Mexico, said Jack Kinzie, an Asarco lawyer.

While Kinzie said the company is investigating that possibility, the federal bankruptcy judge hearing the case, Richard Schmidt, hinted during a December hearing that Asarco might be required to take such a step.

The federal government, through the Justice Department, and more than a dozen states, including Washington, could face similar decisions.

Kinzie said the decision by Asarco to seek bankruptcy protection came so "precipitously" that the company hadn't even hired a financial adviser to help guide it. Since then, a financial adviser has been hired, a legal team assembled and \$75 million in debt financing secured to keep the company operating.

"We have stabilized the company," Kinzie said. "We now need to start dealing with the creditors."

Trying to prove that Grupo Mexico is at the heart of the Asarco bankruptcy won't be easy. Bankruptcy experts say such cases are always difficult to prove, and the task is even harder because of Grupo Mexico's involvement.

"It's not easy to bring a foreign company into a bankruptcy case," said Leif Clark, who teaches at the University of Texas law school and is a bankruptcy judge. "It's not impossible, but it is difficult."

Even serving court papers to foreign parties in a bankruptcy case requires a complicated process spelled out in a 1910 international treaty. And if a judgment against Grupo Mexico was ordered, it could be difficult to collect and may require going into a Mexican court.

Facts about the Superfund

In response to a series of environmental disasters in the 1970s, Congress responded in 1980 by passing the Comprehensive Environmental Response, Compensation, and Liability Act, which created the Superfund.

Here's a look at the program:

How does it work?

The Environmental Protection Agency has assembled a "National Priorities List" of about 1,200 toxic sites, including nearly 50 in Washington state. About one in every four Americans lives within three miles of a Superfund site. As sites are cleaned, they are dropped from the list. New sites can be added.

Who pays for the cleanups?

EPA's goal is to try to find a responsible party to hold accountable for the pollution. Such designations often lead to lawsuits, which frequently are resolved through consent decrees spelling out who will clean up what. If a responsible party can't be found or is financially insolvent, EPA taps the Superfund.

How is the Superfund funded?

Congress collected through a special corporate tax a 9.7-cents-per-barrel fee on crude oil used by U.S. refineries, a tax of up to \$4.87 per ton on certain chemicals and a 0.12 percent tax on corporate income in excess of \$2 million. But the special tax expired in 1995. By some estimates, the taxes would have raised more than \$7 billion over the past 10 years.

Additionally, the \$3.8 billion in the Superfund when the taxes expired in 1995 has essentially been spent. Congress now pumps about \$1.2 billion a year in general tax revenue into the Superfund, and responsible parties contribute about \$900 million annually.

It's not enough. The EPA's inspector general has said funding shortfalls have more than doubled since fiscal 2002 and now stand at about \$250 million annually.

How big is the problem?

Many of the remaining sites on the priority list are so-called megasites, where the cleanups are complicated and costly. According to a recent Government Accountability Office report, it will cost an average of about \$140 million to clean up each of the 142 largest Superfund sites. That's a total price tag of nearly \$20 billion.

What does the EPA say?

EPA officials refused to be interviewed. In response to questions posed by e-mail, EPA spokesman Dave Ryan said work continued at 665 existing Superfund sites in fiscal 2005, and work began at 17 new sites. The agency did not have the money to initiate cleanup at nine new sites.

Ryan refused to say whether the EPA would support reimposing the expired Superfund taxes, but he said the EPA funded cleanups last year at a "level sufficient to maintain effective progress toward construction completion."

The EPA acknowledged that with unlimited resources, cleanups could be accelerated, but the Superfund, like all federal programs, "must operate within the funding levels provided by annual congressional appropriations."

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