March 31, 2009

CORPORATE ALERT

DELAWARE SUPREME COURT REVERSES *LYONDELL*

On March 25, 2009, the Delaware Supreme Court reversed the Delaware Court of Chancery's decision in *Lyondell Chemical Company v. Ryan.*[1] In doing so, the Delaware Supreme Court reaffirmed the breadth of director discretion in fulfilling *Revlon*[2] duties and clarified that only in "extreme" circumstances can disinterested directors be held liable for breach of the duty of loyalty in connection with the sale of the company. The Chancery Court had refused to grant summary judgment on claims that the directors of Lyondell Chemical Company (Lyondell) failed to act in good faith in connection with the 2007 acquisition of Lyondell by Basell AF (Basell). Even though the acquisition price was at a significant premium to the market, the Chancery Court was particularly concerned that the directors had failed for two months to take any actions to prepare for a possible acquisition once Basell made its intentions known, the merger agreement was negotiated in just one week's time after Basell made an offer and the board allegedly had failed to press seriously for a better price or to conduct even a limited market check before agreeing to the merger. Because Lyondell's certificate of incorporation included an exculpatory provision permitted by Section 102(b)(7) of the Delaware General Corporation Law (DGCL), the directors were shielded from personal liability for the breach of the duty of care but not for the breach of the duty of loyalty. The Delaware Supreme Court, however, found no evidence to infer that the directors knowingly ignored their responsibilities—which would give rise to a breach of the duty of loyalty—and, therefore, granted summary judgment in favor of the directors. In reaching its decision, the Delaware Supreme Court clarified that—

- *Revlon* duties do not arise simply because a company is put "in play" by a third party's actions; rather, they arise only when directors choose to embark on a transaction—on their own initiative or in response to an unsolicited offer—that will result in a change in control of the company.

- *Revlon* does not provide a single blueprint that a board must follow. Because every sale is unique, there is no absolute requirement that directors conduct an auction or market check or have impeccable knowledge of the market value of their company in fulfilling their duties to get the best price available.

[1] *Lyondell Chemical Company v. Ryan*, C.A. 3176 (Del. Mar. 25, 2009).
[2] *Revlon v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986).

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- To be held personally liable for breach of their fiduciary duty of loyalty in the transactional context, disinterested directors must have consciously and utterly failed to attempt to obtain the best sale price.

BACKGROUND

In April 2006, Leonard Blavatnik, Basell's controlling shareholder, informed Dan Smith, Lyondell's chairman and CEO, of Basell's interest in acquiring Lyondell. Basell subsequently sent Lyondell's board a letter offering $26.50 to $28.50 per share, which Lyondell rejected as inadequate. In May 2007, an affiliate of Basell filed a Schedule 13D indicating Basell's interest in possible transactions with Lyondell, thereby signaling to the market that Lyondell was "in play." The Lyondell board immediately convened a special meeting to discuss its responses to the Schedule 13D, but decided to take a "wait and see" approach.

On July 9, 2007, Blavatnik, after discussions with Smith, made an oral offer to buy Lyondell for $48 per share (a 45 percent premium to Lyondell's market price on the day before the filing of the Schedule 13D) if Lyondell would agree to a $400 million break-up fee and sign a merger agreement by July 16. Smith called a special meeting of the Lyondell board on July 10 to discuss Basell's offer, at which the board asked Smith to obtain a written offer from Basell, as well as additional details on Basell's financing. The Lyondell board met again on July 11 and 12 to consider the Basell proposal, whereby it determined it was interested, authorized the retention of a financial advisor and instructed Smith to try to negotiate better terms, including a higher price, a go-shop provision and a reduced break-up fee. Blavotnik agreed to reduce the break-up fee to $385 million, but refused Smith's other requests.

On July 16, 2007, the Lyondell board met to consider the Basell merger agreement and to hear reports from Lyondell's management and financial and legal advisors analyzing the deal process and the merits of the transaction. The financial advisor opined that the merger price was "fair" and advised Lyondell that no other entity would likely top Basell's offer. Based on these reports and the substantial premium that Basell was prepared to pay, the board voted to approve the merger and recommend it to the stockholders. Lyondell's stockholders subsequently approved the merger at a special meeting by more than 99 percent of the voted shares.

DELAWARE SUPREME COURT'S REVERSAL OF CHANCERY COURT DECISION

Because Lyondell's certificate of incorporation included an exculpatory provision pursuant to Section 102(b)(7) of the DGCL that protects directors from personal liability for breaches of the duty of care, the Delaware Supreme Court focused solely on whether the directors breached their duty of loyalty by failing to act in good faith, a breach of which would not be exculpated. In reversing the Chancery Court's decision, the Delaware Supreme Court found that the Chancery Court misapplied the applicable law in three respects by (1) imposing *Revlon* duties on Lyondell's directors before they had decided to sell or before the sale had become inevitable, (2) reading *Revlon* and its progeny as creating a set of requirements that must be satisfied during the sale process and (3) equating an arguably imperfect attempt to carry out *Revlon* duties with a knowing disregard of one's duties that constitutes bad faith.

- *Revlon duties do not arise simply because a company is "in play."* The failure by Lyondell's directors to act during the two months after the Schedule 13D filing, despite knowing the company was "in play," was critical to the Chancery Court's analysis of good faith. *Revlon* duties, however, do not arise simply because a company is "in play" but, rather, apply only when a company embarks on a transaction—on its own initiative or in response to an unsolicited offer—that will result in a change of control. The

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Chancery Court focused on the directors' two months of inaction, when it should have focused on the one week when Lyondell's board actually considered Basell's offer, during which time the directors met several times; attempted to negotiate better terms; evaluated Lyondell's value, the price offered and the likelihood of obtaining a better price; and ultimately approved the merger. The board's decision to adopt a "wait and see" approach to Basell's Schedule 13D filing was an entirely appropriate exercise of their business judgment.

- *Revlon does not provide a single blueprint that a board must follow.* The Chancery Court also erroneously concluded that directors must follow one of several courses of action to satisfy their *Revlon* duties. The Delaware Supreme Court makes it clear that there is only one *Revlon* duty—to get the best price for the stockholders at a sale of the company. No court can tell directors exactly how to accomplish that goal, because they will be facing a unique combination of circumstances, many of which will be outside their control. The Chancery Court applied several principles from prior cases under *Revlon*, determining that directors must be actively engaged in the sale process and must confirm that they obtained the best available price either by conducting an auction or market check, or by demonstrating an impeccable knowledge of the market. Because the Lyondell directors did not conduct an auction or market check, and the record did not demonstrate that the directors had an "impeccable" knowledge of the market, the Chancery Court could not conclude that the directors had met their burden under *Revlon*. The Delaware Supreme Court, however, emphasized that the proper analysis was not whether the directors had exercised due care but, rather, whether the directors had failed to act in good faith.

- *To breach the duty of loyalty, directors must have utterly failed to attempt to obtain the best sale price.* The Chancery Court improperly equated an arguably imperfect attempt to carry out *Revlon* duties with a knowing disregard of one's duties that constitutes bad faith. Because there are no legally prescribed steps that directors must follow to satisfy their *Revlon* duties, the directors' failure to take any prescribed steps during the sale process could not have demonstrated a conscious disregard of their duties. The Chancery Court should have focused on whether the directors utterly failed to attempt to obtain the best sale price rather than questioning whether disinterested, independent directors did everything that they arguably should have done to obtain the best sale price. The Delaware Supreme Court stated that there is a vast difference between an inadequate and flawed effort to carry out fiduciary duties and a conscious disregard for those duties. As such, the Delaware Supreme Court noted that Lyondell's directors met several times to consider Basell's premium offer, were aware of the value of Lyondell and the chemical company market in general, received advice from financial and legal advisors and attempted to negotiate a higher offer than the substantial premium Basell had offered. Because these factors do not support a conscious disregard of the directors' duties, the Delaware Supreme Court concluded that Lyondell's directors did not breach their duty of loyalty by failing to act in good faith.

CONCLUSION

The Delaware Supreme Court's decision in *Lyondell* sends a strong message that, absent extreme circumstances, disinterested directors will not be found to have acted in bad faith in connection with the sale of the company. This decision follows on the heels of a recent decision by the Delaware Chancery Court[3] (discussed in our client

[3] *In re Citigroup Inc. Shareholder Derivative Litigation,* Civ. Action 3338-CC (Del. Ch. Feb. 24, 2009).

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alert of March 11, 2009, "Risk Management: Delaware Court Affirms Protection of Business Judgment in Current Financial Crisis") dismissing claims that the directors of Citigroup acted in bad faith by failing to properly oversee the company's business risks. In these cases, the courts reaffirmed that, to establish bad faith, there must be a showing that the directors knew they were not discharging their duties or that the directors demonstrated a conscious disregard for their responsibilities. Taken together, these cases set a high bar that plaintiffs must overcome in establishing that disinterested directors have breached their duty of loyalty.

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