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Victory for Lyondell: Delaware Supreme Court Reaffirms There Is No Single Blueprint For Following *Revlon* Duties

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On March 25, 2009, the Delaware Supreme Court issued its much anticipated opinion in *Lyondell Chemical Company v. Ryan*,[1] which reversed a Delaware Court of Chancery decision that had generated a significant amount of controversy. The Court of Chancery had left open for trial the issue of whether the members of a disinterested and independent board of directors that approved a cash merger with a "blowout" price approximately a week after receiving the merger offer breached their duty of loyalty by acting in bad faith. Among other things, the Delaware Supreme Court's opinion provides important insight and guidance about what a board must do to satisfy so-called *Revlon* duties, and the standard for determining whether a board has acted in bad faith in a merger or transaction context.

Background

As early as April 2006, Basell AF ("Basell"), a global leader in polyolefin technology that is privately owned by Access Industries ("Access"), expressed an interest in purchasing Lyondell Chemical Company ("Lyondell"), one of the largest independent publicly-traded chemical companies in North America. A few months later, Basell sent a written indication of interest to purchase Lyondell for $26.50-$28.50 per share. However, the Lyondell board determined that the price was inadequate and that it was not interested in selling the company. In May 2007, an Access affiliate filed a Schedule 13D with the Securities and Exchange Commission, disclosing its intent to acquire an 8.3% block of Lyondell stock and indicating to the market its interest in a

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possible transaction with Lyondell. Although the Lyondell board recognized that the Schedule 13D filing signaled Lyondell was arguably "in play" (Lyondell's stock price having increased more than 12% on the day the filing was made public), the board decided to take a "wait and see" approach.[2]

In late June 2007, Basell announced that it had entered into a $9.6 billion merger agreement with Huntsman Corporation, a specialty chemical company. However, when another chemical manufacturer, Hexion Specialty Chemicals, Inc., made a superior proposal for Huntsman, Basell returned its attention to Lyondell.[3] On July 9, 2007, in the wake of Hexion's topping bid for Huntsman, Basell offered to acquire Lyondell for its best and final price of approximately $48 per share in cash—a substantial 45% premium over the closing share price on the last trading day before the public was made aware of the potential deal. Under this proposal, Basell would require no financing contingency, but Lyondell would have to agree to a $400 million break-up fee and sign a merger agreement within seven days by July 16, 2007.[4] The full Lyondell board met to initially consider Basell's offer and determined that it was too good to pass on such a substantial premium over the market price. From July 11 to July 16, the parties negotiated the terms of a merger agreement; Basell conducted due diligence; Deutsche Bank prepared a fairness opinion; and the Lyondell board further evaluated the transaction and voted unanimously to approve the merger and recommend it to the stockholders. On November 20, 2007, the merger was approved by more than 99% of the voted shares.[5]

The Litigation

In August 2007, Plaintiff Walter E. Ryan, Jr., a purported shareholder of Lyondell, brought suit in the Delaware Court of Chancery alleging that the Lyondell board members breached their so-called *Revlon* fiduciary duties in conducting the sale of the company to Basell.[6] Plaintiff also argued that Basell, as the acquiror, aided and abetted the purported breach of those duties. After the parties moved for summary judgment, the Court of Chancery heard argument and issued a split decision.[7] The Court of Chancery granted summary judgment on all claims in favor of Basell, and dismissed Basell from the case. The Court also granted summary judgment in favor of the Lyondell defendants on what it termed "structural" loyalty claims.[8]

Specifically, the Court of Chancery found that the Lyondell directors were disinterested and independent and that they impartially considered the Basell merger proposal. The Court also concluded that the directors' equity ownership in Lyondell properly incentivized them to achieve the highest price attainable for Lyondell shares in the merger. Moreover, the Court found that the $48 per share merger price was "undeniably" fair and "may well have been the best that could reasonably have been obtained in that market or any market since then."[9] Further, the Court also granted summary judgment on all disclosure claims on the ground that the proxy materials sent to Lyondell stockholders disclosed, in a full and accurate manner, the material information to which stockholders were entitled.[10]

However, the Court left open for trial an issue that would come to generate a level of controversy that had not been seen since the Delaware Supreme Court's decision in *Omnicare* earlier in the decade. Despite concluding that the merger was negotiated at arm's-length by an independent and unconflicted board of directors, remarking that the merger price was "undeniably fair," and noting that the shareholders overwhelmingly approved the transaction (more than 99% of those shareholders that voted, voted in favor of the merger), the Court of Chancery held that it could not conclude on the current record that the Lyondell board adequately complied in "good faith" with its *Revlon* duties to ensure that it had secured the best transaction reasonably available to the Lyondell shareholders.[11] By so concluding, the Court managed to avoid dismissing the case pursuant to Lyondell's exculpation provision, which—pursuant to Section 102(b)(7) of the Delaware General Corporation Law—bars monetary damages for breaches of the duty of care. In particular, the Court took issue with the fact that the deal was considered, negotiated and approved by the Lyondell board in less than seven days, that the Lyondell board never auctioned the company or otherwise actively conducted a market check or shopped Basell's offer to determine if $48 was indeed the highest value reasonably attainable, and that the Lyondell board agreed to certain, typical deal protection provisions (which the Court concluded were not coercive).[12]

Though it was something of a long shot, the defendants moved for certification of an interlocutory appeal from the aspect of the Court of Chancery's decision denying summary judgment. Not surprisingly, the Court of Chancery denied defendants' application, and restated its position that the directors' alleged failure to "engage" fully in the sales process might constitute "bad faith" under Delaware law.[13] Notably, in denying the request for an interlocutory appeal, the Court of Chancery shifted its focus from the week-long period that the board actually considered the Basell offer, to the two-month period prior to receiving the Basell offer when Lyondell allegedly became "in play" as the result of the filing of a Basell Schedule 13D. The Court of Chancery noted that after the 13D was filed, the Lyondell board members "made *no apparent effort* to arm themselves with *specific knowledge* about the present value of the Company. . .despite *admittedly knowing* that the 13D filing. . .effectively put the Company 'in play,' and, therefore, presumably, also knowing that an offer for the sale of the Company could occur at any time. It is these facts that raise the specter of 'bad faith' in the present summary judgment record . . . ."[14]

On the same day that Vice Chancellor Noble denied defendants' interlocutory appeal, Chancellor Chandler issued *McPadden v. Sidhu*[15] and on the following business day, Vice Chancellor Strine issued *In re Lear Corporation Shareholder Litigation*,[16] both of which dismissed claims of director "bad faith" in the context of a board's approval of a transaction. Though *Ryan* is not mentioned in either of these opinions, the Court's comments about what constitutes a "bad faith" claim may well have been made in response to that decision. Shortly thereafter, the Delaware Supreme Court accepted the interlocutory appeal to consider the claim that the Lyondell directors failed to act in good faith in conducting the sale of Lyondell. In its opinion, the Delaware Supreme Court explained that the Court of Chancery "approached the record from the wrong perspective" and reversed the Court of Chancery's decision, holding that the "record clearly establishes that the Lyondell directors did not breach their duty of loyalty by failing to act in good faith."[17] In particular, the Supreme Court held "[t]here is no evidence…from which to infer that the directors knowingly ignored their responsibilities, thereby breaching their duty of loyalty."[18]

Specifically, the Delaware Supreme Court found that the Court of Chancery "reviewed the existing record under a mistaken view of the applicable law," and outlined "three factors [that] contributed to that mistake."[19] First, the Court of Chancery improperly imposed *Revlon* duties on the Lyondell directors before they either had decided to sell, or before the sale had become inevitable. In addition, the Supreme Court refused to find that the filing of a Schedule 13D by Basell, which arguably put the company "in play" about two months before Basell made its formal merger offer, triggered *Revlon* duties. Second, the Court of Chancery mistakenly read *Revlon* and its progeny as creating a set of requirements that must be satisfied during the sale process. Critically, the Delaware Supreme Court reiterated that "there is no single blueprint that a board must follow to fulfill its [*Revlon*] duties" when selling a company and that "[n]o 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."[20] Third, the Court of Chancery wrongly equated an arguably imperfect attempt to carry out *Revlon* duties with a knowing disregard of one's duties that constitutes bad faith. On this point, the Supreme Court held that "there are no legally prescribed steps that directors must follow to satisfy their *Revlon* duties. Thus, the directors' failure to take any specific steps during the sale process could not have demonstrated a conscious disregard of their duties."[21] Further, the Supreme Court noted that, "[m]ore importantly, there is a vast difference between an inadequate or flawed effort to carry out fiduciary duties and a conscious disregard for those duties" and cited *Lear* for the proposition that "[i]n the transactional context, [an] extreme set of facts [is] required to sustain a disloyalty claim premised on the notion that disinterested directors were intentionally disregarding their duties."[22]

As a result, the Delaware Supreme Court found that at most what was left for trial was a claim for money damages stemming from a potential breach of the duty of care, which was barred by an exculpatory provision in Lyondell's charter adopted pursuant to Section 102(b)(7) of the Delaware General Corporation Law. Thus, the Delaware Supreme Court reversed the Court of Chancery's decision

and remanded the matter for entry of judgment in favor of the Lyondell directors.[23]

Discussion

There are a number of takeaways from this important Delaware Supreme Court decision. Among them are the following:

First, the Delaware Supreme Court confirmed the long-standing understanding that *Revlon* was not intended to create a separate or distinct fiduciary duty from directors' duties of care and loyalty. Instead, *Revlon* simply held that the "board must perform its fiduciary duties in the service of a specific objective: maximizing the sale price of the enterprise."[24]

Second, the Delaware Supreme Court clarified that *Revlon* duties do not arise simply because a company is "in play." Instead, "[t]he duty to seek the best available price applies 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."[25] Here, the Supreme Court concluded that the time for action under *Revlon* did not begin until the directors began negotiations with Basell for the sale of Lyondell. The Supreme Court also noted that the Lyondell directors' "wait and see" approach in the wake of Basell's Schedule 13D filing was an entirely appropriate exercise of the directors' business judgment.

Third, the Delaware Supreme Court emphasized the flexibility that directors have in attempting to satisfy their *Revlon* duty of seeking the best available price for 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. As we noted in *Barkan v. Amsted Industries, Inc.*, 'there is no single blueprint that a board must follow to fulfill its duties.'"[26]

Fourth, the Delaware Supreme Court emphasized that something much more drastic than what occurred in this case needs to happen before a Court should infer disloyal intent—whether an intent to do harm to the company, or the conscious disregard of fiduciary duties—in the transaction context. At a minimum, a plaintiff cannot articulate a claim for breach of the fiduciary duty of loyalty by acting in bad faith just by pointing out that a board did nothing to prepare for an offer after recognizing that a company is "in play" based on a 13D filing, or by pointing out that the board did not conduct a market check before agreeing to a merger. As the Supreme Court explained, this is because "there are no legally prescribed steps that directors must follow to satisfy their *Revlon* duties. Thus, the directors' failure to take any specific steps during the sales process could not have demonstrated a conscious disregard of their duties. More importantly, there is a vast difference between an inadequate or flawed effort to carry out fiduciary duties and a conscious disregard for those duties."[27]

Fifth, and perhaps most important for directors faced with challenging and difficult decisions in the transactional context, the Delaware Supreme Court recognized that directors should not be held to an impossible standard, holding that "[d]irectors' decisions must be reasonable, not perfect."[28] The Delaware Supreme Court found, in stark contrast to the Court of Chancery, that there was "no evidence. . .from which to infer that the directors knowingly ignored their responsibilities, thereby breaching their duty of loyalty."[29] This is a critical aspect of the decision, because any remaining claim relating to *Revlon* would be for money damages stemming from a breach of the duty of care—a claim that is barred by the exculpatory provision in Lyondell's charter adopted pursuant to Section 102(b)(7) of the Delaware General Corporation Law.

From this, directors should be able to take comfort that good faith decisions, made in the best interests of the company, will not expose them to personal liability, even if in hindsight those decisions turn out to be wrong.

NOTES

1. No. 401, 2009 Del. LEXIS 152 (Del. Mar. 25, 2009).
2. *Id.* at *4.
3. Hexion later brought suit unsuccessfully against Huntsman in an attempt to extricate itself from the merger transaction by asserting that Huntsman had suffered a material adverse change and the combined entity would be insolvent. *See Hexion Specialty Chems., Inc. v. Huntsman Corp.*, 965 A.2d 715 (Del. Ch. 2008). The parties eventually settled with Huntsman terminating the deal and receiving a substantial amount of money as part of the settlement.
4. *Lyondell*, 2009 Del. LEXIS 152, at *5.
5. *Id.* at *8.

6. Similar litigation seeking to enjoin the merger transaction was also brought in the District Court of Texas. Lyondell and Basell were victorious in Texas, and the Court denied the application for a preliminary injunction. *See Plumbers & Pipefitters Local 51 Pension Fund v. Lyondell Chem. Co.*, C.A. No. 2007-43958. The Plaintiff here did not seek a preliminary injunction (or any other expedited action) in the Delaware proceeding.
7. *See Ryan v. Lyondell Chem. Co.*, C.A. No. 3176-VCN, 2008 Del. Ch. LEXIS 105 (Del. Ch. July 29, 2008).
8. *Id*. at *10-11.
9. *Id*. at *118.
10. The Court did, however, identify one "minor" issue related to the non-disclosure of a management-derived weighted average cost of capital estimate, which Lyondell's banker believed to be unreliable and did not use to perform its valuation analysis. Nevertheless, the Court dismissed the potential disclosure claim on the ground that damages resulting from any violation would be barred by Lyondell's exculpatory provision based on Section 102(b)(7) of the Delaware General Corporation Law. *Id*. at *11.
11. *Id*. at *118.
12. *Id*. at *64-71, 82-84.
13. *Ryan v. Lyondell Chem. Co.*, C.A. No. 3176-VCN, 2008 Del. Ch. LEXIS 125, at *12-13 (Del. Ch. Aug. 29, 2008).
14. *Id*. at *14.
15. 964 A.2d 1262, 1263 (Del. Ch. 2008) (stating in the opening paragraph of the opinion that "it is quite clearly established that gross negligence, alone, cannot constitute bad faith," and, "[t]hus, a board of directors may act 'badly' without acting in bad faith").
16. C.A. No. 2728-VCS, 2008 Del. Ch. LEXIS 121, at *41-42 (Del. Ch. Sept. 2, 2008) (explaining that "[b]oards may have to choose between acting rapidly to seize a valuable opportunity without the luxury of months, or even weeks, of deliberation—such as a large premium offer—or losing it altogether," and therefore, Courts should be "extremely chary about labeling what they perceive as deficiencies in the deliberations of an independent board majority over a discrete transaction as not merely negligence or even gross negligence, but as involving bad faith").
17. *Lyondell*, 2009 Del. LEXIS 152, at *21-22.
18. *Id*. at *2-3.
19. *Id*. at *13-14.
20. *Id*. at *18.
21. *Id*. at *20.
22. *Id*. at *20-21 (*citing In re Lear Corp. S'holder Litig.*, 2008 Del. Ch. LEXIS 121, at *42).
23. *Id*. at *23.
24. *Id*. at *9.
25. *Id*. at *16.
26. *Id*. at *18.
27. *Id*. at *20.
28. *Id*. at *20-21.
29. *Id*. at *2-3.