DELAWARE SUPREME COURT OVERTURNS *LYONDELL* DECISION ON *REVLON* AND THE DUTY OF GOOD FAITH

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To Our Clients and Friends:

The Delaware Supreme Court yesterday overturned the Chancery Court's controversial 2008 decision denying summary judgment in favor of the directors of Lyondell Chemical Company on *Revlon* claims arising from Lyondell's $13 billion sale to Basell AF. *Lyondell Chemical Co. v. Ryan*, C.A. No. 3176 (Del. March 25, 2009). The Chancery Court decision, *Ryan v. Lyondell Chemical Co.*, C.A. No. 3176-VCN (Del. Ch. July 29, 2008), had provoked criticism because it held that independent, disinterested directors who approved a high-premium cash merger on customary terms may nevertheless have breached their duty of good faith by failing to engage in a more proactive and protracted sale process. Please see our memorandum of August 4, 2008. The Delaware Supreme Court's *en banc* decision is an important affirmation of both the principle that Delaware directors are entitled to exercise their business judgment in deciding how to maximize value in a sale transaction and the high barriers plaintiffs face in successfully pleading that directors have failed to act in good faith.

A little over a year after Lyondell rebuffed Basell's proposals to acquire Lyondell at prices ranging from $24 to $28.50 per share, a Basell affiliate acquired an 8.3% stake and filed a Schedule 13D disclosing Basell's interest in a transaction with Lyondell. Lyondell's board met to review the filing and decided to take a "wait and see" approach. Although the Schedule 13D arguably had put Lyondell "in play," the only other party to come forward was a private equity firm that proposed a management buyout, which Lyondell decided not to pursue. On June 26, Basell agreed to acquire Huntsman Corporation for $9.6 billion, but turned back to Lyondell after its bid for Huntsman was topped. On July 9, Basell initially offered Lyondell $40, but quickly raised the price to $44 to $45. When Lyondell's CEO said he would present the offer to the board but doubted it would accept it, Basell responded with a "best" offer of $48 per share, provided Lyondell signed a merger agreement by July 16 with a $400 million break-up fee. Lyondell's board met to consider the offer and decided to ask Basell for a written offer and more information about its financing. Basell complied, but said it needed a firm indication of interest from Lyondell by July 11, the deadline for making a new bid for Huntsman. Lyondell's board met again on July 11 and instructed the CEO to negotiate for a higher price and looser deal protection terms. Basell refused to increase its price, but agreed to reduce the break-up fee to $385 million. On July 16, Lyondell's board approved the merger, which was later overwhelmingly approved by Lyondell stockholders.

The Delaware Supreme Court, reviewing recent case law considering the duty of good faith, emphasized that, absent an actual intent to do harm, bad faith must involve "intentional dereliction of duty," (quoting *Disney*) and that liability for bad faith "'requires a showing that directors knew that they were not discharging their fiduciary obligations'" (quoting *Stone v. Ritter*). The Court found that the Chancery Court had recognized these principles, but misapplied them because of three mistakes in its *Revlon* analysis.

First, the Court noted that the Chancery Court's sharp criticism of Lyondell's board for its "two months of slothful indifference" following Basell's Schedule 13D filing was inappropriate because "*Revlon* duties do not arise simply because a company is 'in play.' The duty to seek the best available price arises only when a company embarks on a transaction … that will result in a change in control." The Court held that the board's decision to take a "wait and see" approach was "an entirely appropriate exercise of the directors' business judgment."

The Court also rejected the Chancery Court's suggestion that some specific set of steps was required during a sale process. According to the Court, there is "only one *Revlon* duty" – the duty to get the best price reasonably available – and "[n]o court can tell directors exactly how to accomplish that goal, because they will be facing a unique set of circumstances, many of which will be outside their control." This holding is fully consistent with the Delaware Supreme Court's holding in the *Barkan* case that "there is no single blueprint" for directors to fulfill their duties.

Finally, the Court found that the Chancery Court erred by "equating an arguably imperfect attempt to carry out *Revlon* duties with a knowing disregard of one's duties that constitutes bad faith." The Court acknowledged that the Lyondell directors had not conducted an auction or market check, and may not have had "impeccable" market knowledge about the company's value – factors that left the Chancery Court unable to conclude that the directors had fulfilled their *Revlon* duties. While the Court disagreed with this conclusion, it said it would not have disturbed it had the issue been whether the directors acted with due care. However, because Lyondell's directors were exculpated for breaches of the duty of care, the issue in the case was whether they acted without good faith, which the Court noted sets a far higher bar for the plaintiffs.

According to the Court, "there is a vast difference between an inadequate or flawed effort to carry out fiduciary duties and a conscious disregard of those duties." The question was not whether the directors did all they should have done; it was whether they had "knowingly and completely failed to undertake their responsibilities." Accordingly, because the Lyondell directors met several times to consider Basell's offer, were generally aware of the value of their company and the chemical company market, acted on the advice of their legal and financial advisers and attempted to negotiate a higher offer even though they considered $48 to be a

"blowout" price, the record clearly established that Lyondell directors did not breach their duty of loyalty by acting in bad faith.

Dicta in other cases (*McPadden v. i2 Technologies, Inc.* and *In re Lear Corp. Shareholder Litig.*) as well as responses from many commentators and practitioners had previously indicated that the original *Lyondell* holding aroused concern. The Delaware Supreme Court decision is a welcome resolution.

Please feel free to contact us with any questions.

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