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Lessons For Boards Of Directors In Considering Acquisition Proposals: New Decision Sheds Further Light On *Revlon* And *Omnicare* Duties

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On July 29, 2008, the Delaware Chancery Court issued a ruling in connection with Basell AF's December 2007 acquisition of Lyondell Chemical Company. Basell acquired Lyondell for $48 per share ($13 billion) in cash, which represented a 45% premium over Lyondell's stock price prior to public knowledge of Basell's interest in acquiring the company and a 20% premium over the stock price prior to the announcement of the entry into a merger agreement. The merger was overwhelmingly approved by the Lyondell stockholders voting on the transaction. Surviving the acquisition, however, was a stockholder class action challenging the actions of Lyondell's board of directors in connection with the transaction.

In its ruling on the defendants' motion for summary judgment, the Court allowed certain of the stockholder claims to continue, including allegations of breaches of *Revlon* and *Omnicare* duties. The ruling by the Court provides a number of lessons for boards of directors of targets when constructing deal processes and documenting their observance of their fiduciary duties.

Transaction Background

Basell first showed interest in acquiring Lyondell in 2006 and submitted an expression of interest for $26.50-28.50 per share, which the Lyondell Board rejected as inadequate. In the spring of 2007, Basell acquired rights to purchase up to 8.3% of Lyondell's stock from Lyondell's then second largest

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stockholder and disclosed in a filing with the Securities and Exchange Commission its acquisition of such rights and the possibility of a bid to acquire control of Lyondell. Further meetings occurred between Basell and Lyondell's chief executive officer, who was also chairman of its board of directors, eventually leading to Lyondell's chief executive officer pushing Basell to present its "best price" offer for the company. At the same time, Basell was bidding to acquire another chemical company, Huntsman Corporation.

On July 9, 2007, Basell, in discussions solely with Lyondell's chief executive officer, confirmed its $48 per share cash offer (with no financing contingency) conditioned on the acquisition agreement being signed by July 16, 2007, and containing a $400 million break-up fee. Between July 10 and July 16, 2007, the Lyondell Board met at various times to review the transaction and, after gaining an indication of Lyondell's interest, Basell ceased its attempts to buy Huntsman and focused its energies on acquiring Lyondell.

On July 15, 2007, Lyondell attempted to negotiate deal concessions from Basell to increase the offer price, add a "go-shop" provision into the merger agreement, and to reduce and restructure the break-up fee – with the only concession agreed to by Basell being a small reduction in the break-up fee to $385 million. On the July 16, 2007 deadline, the Lyondell Board approved the transaction.

In its ruling, the Court noted that the stockholders received a "blow-out" market premium in the acquisition and undeniably received a "fair" price, but may not have received the "best" price. Furthermore, the Court saw a troubling board process at Lyondell in their handling of the transaction. Within that context and the constraints of the summary judgment process, the Court determined that it could not find in favor of the Lyondell Board in several respects.

Maximizing Stockholder Value (*Revlon Duties*)

As described by the Court, boards of directors have a duty under *Revlon* in the context of a company sale to have a "singular focus on seeking and attaining the highest value reasonably available to stockholders." Highest value is seen as not necessarily simply accepting the highest dollar bid but can include other deal terms that maximize the value to stockholders.

In the context of a change of control for cash, the actions of the target board are subject to a higher standard of review than the business judgment rule. Specifically, under this higher enhanced scrutiny standard, the Court may examine the decision-making process employed by the board (including the information they relied upon) and also may examine the actions of the board in light of the circumstances then existing. The Court was clear in this case in its view that *Revlon* does not demand a perfect process, but rather that a target board needs to adopt a process demonstrating its reasonable effort to advance the interests of the target's stockholders.

In the present case, the defendants made a number of arguments against the plaintiffs' claims. Specifically, the defendants argued that it was self-evident that the Basell deal was the "best" deal for the following reasons:

- the Lyondell Board had obtained a fairness opinion from a financial advisor;
- the Lyondell Board had good reasons to suspect that no other bidders would be forthcoming;
- Lyondell had effectively been "in play" for some time (with no other serious bids received); and
- a post-signing deal check had effectively occurred as no topping bid was received.

The Court expressed its concern that the entire deal had been largely negotiated, considered by the Lyondell Board and agreed to within seven days. In addition, during such period the Board had met for no more than six or seven hours in total, including for purposes of reviewing the definitive merger agreement. The Court stated that such "statistics do not inspire confidence that the Board carefully considered all the alternatives available to Lyondell." The Court also was skeptical of the defendants' argument that Lyondell had been in play, stating that the record showed that the Board took no action in anticipation of other bids, that the evidence did not support the argument of a post-signing market check and that there was little evidence that the Board actively participated in the sale process.

The Court also noted that a fairness opinion only speaks as to whether the offer is fair to the stockholders from a financial point of view, but does not establish the offer as the best deal available. Specifically, the Court stated that a fairness opinion coupled with speculation as to whether other bids would be received (and a decision not to actively solicit bids) does not discharge a Board's *Revlon* duties.

In reviewing the arguments in its decision, the Court reviewed the Delaware Supreme Court's decision in *Barkan v. Amstead*

Industries, noting that, in some circumstances, a sale to a single bidder without a market check may not breach the *Revlon* duties, where the target's board "possesses a body of reliable evidence with which to evaluate the fairness of the transaction." When applied to the Lyondell Board however, the Court was quick to distinguish the present case stating that the record did not show that the Lyondell Board had this type of evidence during their review of the Basell bid.

The Court ruled against the defendants holding that, on summary judgment, while the Lyondell stockholders may have received a "blow-out" price, in this case, the record showed that the Board was not proactive in determining whether a better deal could be obtained and did not have a sufficient level of knowledge of the value of Lyondell to make such proactive efforts unnecessary. In the eyes of the Court, "[e] ssentially the Board acted as a passive conduit to the stockholders for an unsolicited, attractive bid for the Company."

Walking the Tightrope of Balancing Deal Protection Measures (*Omnicare* Duties)

Deal protection measures such as "no-shop" provisions, fiduciary out limitations, break-up fees, matching rights, voting lockups and "force-the-vote" mechanisms can bring deal certainty to transactions and result in securing premium bids for targets. Within this context, however, boards of directors of targets need to be cognizant of their *Omnicare* duties to, as described by the Court in this case, avoid such measures becoming preclusive or coercive and to ensure such measures are "reasonable in light of the circumstances."

In the Lyondell case, the plaintiffs argued that the cumulative effects of the level of deal protection measures had the effect of both coercing stockholders to approve the transaction, as well as precluding other bids for Lyondell. With respect to the argument that the measures coerced the stockholders, the Court rejected this argument as unfounded, stating that the stockholders had a clear choice to accept the offer or to vote to continue Lyondell as an independent company. Further, no break-up fee would have been payable by Lyondell as a result of a simple "no" vote by its stockholders.

With respect to the second issue, the Court examined the defendants' arguments that the deal protection measures were a condition to Basell making the offer and that the premium in the deal justified the Board agreeing to these measures. The Court found that there was no evidence that the Board aggressively negotiated the protection measures or threatened to, or would have, walked away from the transaction, nor any evidence explaining why measures of this scope were agreed to or considered appropriate. Rather, the Court showed its skepticism of the Board's decision to agree to the measures as "a matter of course" where such measures "limited the Board's ability to proactively discharge its fiduciary duties after the fact."

The Court ruled against the defendants holding that there was no evidence to exclude the plaintiffs' inference that the deal protection measures served no purpose other than to limit the possibility of competing bids and stated that a difficult and demanding buyer is no justification for agreeing to such measures without adequate evidence that the Board had no choice but to accept the offer as presented. As stated by the Court, ". . . the Board did nothing (or virtually nothing) to confirm the superiority of the price, but, nonetheless, it provided Basell a full complement of deal protections."

New Limitations on Director Exculpatory Provisions?

Lyondell's charter contained a typical exculpatory provision, as permitted under Section 102(b)(7) of the Delaware General Corporation Law, limiting the personal liability of directors to the corporation or its stockholders for monetary damages for breach of fiduciary duty claims, subject to exceptions, including breaches of the duty of loyalty or bad faith acts or omissions. The Court noted that the only way for the plaintiffs to prevail on a *Revlon* claim – considering the Lyondell Board's independence and no evidence of self-interest – would be if the plaintiffs could demonstrate that the Board was either disloyal or failed to act in good faith.

Interestingly, the Court expressly stated that the Board's failure to be active in the sale may constitute a breach of the good faith component of the duty of loyalty as outlined in *Stone v. Ritter* and therefore preclude a Section 102(b)(7) defense. Furthermore, the Court stated that the same limitations applied to the *Omnicare* (deal protection) claims because they are inextricably linked to the *Revlon* claims. The Court again was careful to note that its view of the record was in the context of a ruling of a motion for summary judgment and a more developed record at trial may satisfy the Court that the Board's efforts were made in good faith. Nonetheless, this view may be seen as a narrowing of the scope of exculpatory provisions and undoubtedly will be subject to intense debate.

Conclusions – "Take Aways"

While recognizing that this decision is only a ruling on defendants' motion for summary judgment and not a judgment on the full merits of the case, the decision does provide a number of insights into best practices useful for boards of directors of targets to consider in the context of their *Revlon* and *Omnicare* duties. These include the following:

- Boards should set clear guidelines for their members and company executives to report back to the full board of possible bids and transactional interest.
- Boards should be directly involved early on in the negotiating of a transaction (even in transactions with compressed timeframes) and be wary of the degree of delegation to a single director or management in negotiating a transaction.
- Boards should ensure that a clear record of their involvement in the process is maintained and, while the substance of deliberations cannot be measured based on the number or length of meetings, recognize the importance of holding detailed and comprehensive reviews of the transaction and alternatives.
- Boards should consider what steps, if any, may be appropriate to prepare for indications of interest from possible acquirors, including retaining advisors early on and obtaining information in anticipation of reviewing proposals.
- While deal protection measures are typical features of transactions, boards should consider carefully the effect of such measures on the discharge of their fiduciary duties and whether the company is receiving some form of benefit in exchange for agreeing to such structures which make the measures appropriate.
- Specifically with regard to market checks, boards should consider carefully what pre- and post-signing market check mechanisms (e.g., "go-shop" provisions) should be required as part of the transaction and document the negotiating process for the mechanisms finally agreed to.

The Court in this ruling was clear that – even in the context of a premium price and an overwhelming stockholder vote for the transaction – boards of directors of Delaware corporations are "expected to take context-appropriate steps to assure themselves and, thus, their shareholders that the price to be paid is the 'best price reasonably available.'"

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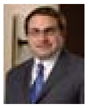

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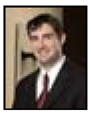

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