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Delaware Supreme Court Reaffirms Exculpation Protections in Sale of Corporate Control and Clarifies *Revlon* Duties

Recently, in *Lyondell Chem. Co. v. Ryan*[1], the Delaware Supreme Court reaffirmed the protections afforded directors in their efforts to obtain the best price in a corporate sale and provided important clarification of directors duties in navigating change of control transactions.

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The Delaware Court of Chancery had denied a motion for summary judgment by Lyondell's independent directors, finding that the record presented a triable issue of fact on the question of whether "unexplained inaction" on the part of the directors implied a knowing disregard of their fiduciary duties to the shareholders. The Delaware Supreme Court concluded that the Court of Chancery had imposed the fiduciary duties concerning change of control transactions – i.e., *Revlon* duties – on the Lyondell directors prematurely and too rigidly, and mistakenly had "equated an arguably imperfect attempt to carry out *Revlon* duties with a knowing disregard" of their fiduciary duties.

The Underlying Case

In 2006, Lyondell Chemical Company, a publicly-traded American chemical company, received an unsolicited acquisition offer from Basell AF, a privately held Luxembourg company. Lyondell's board determined that the offer price of $26.50-$28.50 per share was too low and rejected the offer. A year later, in May 2007, an affiliate of Basell filed a Schedule 13D with the SEC, indicating both its right to acquire a non-controlling interest in Lyondell and its intent possibly to engage in various transactions with Lyondell. During a special meeting of the Lyondell board, it was decided that the company would not put itself up for sale and, instead, would await the market's reaction to the Schedule 13D filing. Except for one passing suitor, little interest was received in response to the 13D filing. In anticipation of an eventual deal, however, Lyondell's stock price rose approximately 11%, maintaining at or around $37 per share for the next several weeks. In July 2007, Basell made an opening offer of $40 per share and eventually made its best offer of $48 per share in cash. The offer was contingent upon the execution of an agreement within seven days and a break-up fee of $400 million.

Within two days of the best offer, the Lyondell board met twice, authorized the CEO to negotiate with Basell and engaged Deutsche Bank as a financial advisor. During the ensuing negotiations, Lyondell sought an increase in the price, a reduction in the break-up fee and a go-shop provision but only succeeded in obtaining a reduction of the break-up fee to $385 million. The Deutsche Bank's managing director described the price as "an absolute home run" and Deutsche Bank opined that the $48 per share offer was fair. Deutsche Bank also expressed the view that a higher offer from another suitor was unlikely. Seven days after receipt of the offer, having concluded that the Basell offer contained a substantial premium of 45% over the pre-Schedule 13D market price, the Lyondell board unanimously approved the merger agreement and recommended the merger to the shareholders. On November 20, 2007, the merger was approved by more than 99% of the voted shares.

A stockholder complaint was filed in the Court of Chancery against the independent directors of Lyondell for their role in the sale of the company to a strategic buyer. The complaint alleged, among other things, that the directors breached their fiduciary obligation to obtain the best price reasonably available, as articulated in *Revlon*, for the corporate sale. Vice Chancellor Noble noted that the Lyondell charter includes the exculpatory provision modeled after Section 102(b)(7) of the Delaware General Corporation Law, which protects directors from personal liability arising from breaches of the duty of care but does not shield directors when they have a pecuniary interest in the challenged transaction or engage in acts not taken in "good faith," either of which implicate the duty of loyalty. Thus, a claim based on a failure to observe the duty of care was foreclosed. The Court of Chancery, however, denied the directors' motion for summary judgment, having found that the board's inaction after the filing of the Schedule 13D and other process deficiencies gave rise to a permissible inference that the directors acted in bad faith by consciously disregarding their duties, and thus violated their duty of loyalty to the shareholders.

The Decision of the Delaware Supreme Court

Because the Court of Chancery had found that the Lyondell board was "independent and not motivated by self-interest or ill will," the sole issue before the Delaware Supreme Court was whether the directors were entitled to summary judgment on the claim that they breached their duty of loyalty by failing to act in good faith. Examining recent decisions construing "good faith," the Supreme Court held that bad faith (i.e., the absence of good faith) required intentional dereliction of duty on the part of the directors. The Court concluded that the record did not present a triable issue as to whether the directors knowingly disregarded their responsibilities to the company. Instead, the Court concluded that the record in *Lyondell*, at most, created an issue of fact as to whether the directors breached their duty of due care, for which, as the Court of Chancery had noted, the company's charter eliminated monetary recovery.

The Delaware Supreme Court reaffirmed that, under *Revlon*, directors are afforded wide flexibility in their efforts to obtain the best price in selling control of the company. In reversing the Court of Chancery, the Supreme Court determined that the lower court misinterpreted the scope of the *Revlon* duties.

First, the Delaware Supreme Court rejected the Vice Chancellor's conclusion that *Revlon* duties automatically arise when the company is "put in play" as Lyondell was, according to Vice Chancellor Noble, when Basell filed its Schedule 13D. The Supreme Court held that "[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", and thus an action by a third party that falls short of an offer does not trigger *Revlon* duties. Accordingly, the period of "inaction" that had troubled the Court of Chancery – the two months between the Schedule 13D filing and the receipt of a specific offer – was not the time period the court should have focused on under a *Revlon* analysis and the directors' decision to "wait and see" was an appropriate exercise of their business judgment.

Second, the Delaware Supreme Court held that the Court of Chancery erroneously concluded that the directors must follow one of several courses of action to meet their *Revlon* obligation to obtain the best price: conducting an auction, conducting a market check or demonstrating an "impeccable knowledge of the market." The Supreme Court found that "there are no legally prescribed steps that directors must follow to satisfy their *Revlon* duties." Reaffirming existing Delaware law, the Supreme Court held 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[n] unique combination of circumstances, many of which will be outside their control. . . . "[T]here is no single blueprint that a board must follow to fulfill its duties" (citations omitted).

Third, the Delaware Supreme Court determined that the Court of Chancery adopted the wrong perspective in assessing the Lyondell directors' process for the sale. The Court of Chancery questioned whether the

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"unexplained inaction" by the independent directors following the Schedule 13D filing amounted to an exhaustive effort to obtain the best value for the Lyondell shareholders. As noted by the Supreme Court, however, "[o]nly if [the directors] knowingly and completely failed to undertake their responsibilities would they breach their duty of loyalty." The Supreme Court explained that "there is a vast difference between an inadequate or flawed effort to carry out fiduciary duties and a conscious disregard for those duties." Accordingly, the Court of Chancery should have assessed whether the board "utterly failed to attempt to obtain the best sale price." Viewing the record in this manner, the Supreme Court concluded that the duty of loyalty is not implicated even if directors fail to do everything that can be done to obtain the best price.

In *Lyondell*, the Delaware Supreme Court reaffirmed its prior "good faith" analyses and provided significant assurance that the "good faith" exception to exculpation provisions is limited in scope so as not to consume the exculpation protections afforded directors under 8 *Del. C.* § 102(b)(7). Nonetheless, directors and their advisors must be mindful that § 102(b)(7) only precludes money damage claims and does not impact equitable relief, such as restraining orders or preliminary injuctions, that can interfere with completing the transaction. Although the Delaware Supreme Court gave broad latitude to directors in satisfying their *Revlon* duties, a board must still be diligent about the sale process and create a careful record of the effort to obtain the best price in a change of control transaction in order to ensure deal certainty.

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[1] Lyondell Chem. Co. v. Ryan, -- A.2d --, No. 401-2008, 2009 WL 1024764 (Del. Mar. 25, 2009).
[2] Revlon Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

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