Delaware Supreme Court Reverses *Lyondell*; Clarifies When *Revlon* Duties Attach and Standard for Bad Faith

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The Delaware Supreme Court recently reversed the Delaware Court of Chancery's decision in *Lyondell Chemical Co. v. Ryan*,[1] denying summary judgment for the directors of Lyondell Chemical Company ("Lyondell") as to *Revlon* and "deal protection" claims and whether the directors of Lyondell breached their duty of loyalty in connection with the acquisition of Lyondell by Basell AF ("Basell"). Because the trial court determined that the Lyondell board was independent and was not motivated by self-interest or ill will, the sole issue on appeal 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. Concluding that the directors did not breach their duty of loyalty, the Supreme Court stated:

[T]he record establishes that the directors were disinterested and independent; that they were generally aware of the company's value and its prospects; and that they considered the offer, under the time constraints imposed by the buyer, with the assistance of financial and legal advisors. At most, this record creates a triable issue of fact on the question of whether the directors exercised due care. There is no evidence, however, from which to infer that the directors knowingly ignored their responsibilities, thereby breaching their duty of loyalty.

Notably, the Supreme Court determined that *Revlon* duties do not arise until a company has embarked on a transaction that will result in a change of control, as opposed to when a company is simply "in play," and reaffirmed that "there is no single blueprint that a board must follow" to satisfy its *Revlon* duties. In addition, relying on *In re Walt Disney Co. Deriv. Litig.*,[2] *Stone v. Ritter*,[3] and *In re Caremark Int'l Deriv. Litig.*,[4] the Supreme Court concluded that the Court of Chancery erroneously equated the Lyondell board's arguably imperfect attempt to carry out its *Revlon* duties to a knowing disregard of one's duties that would constitute bad faith. Accordingly, the Supreme Court remanded the matter for entry of judgment in favor of the Lyondell directors.

Factual Background

Lyondell was a publicly traded company headed by its chairman and CEO, Dan Smith; Lyondell's other ten directors were independent. In April 2006, Leonard Blavatnik, the owner of Basell through his ownership of Access Industries, told Smith that Basell was interested in acquiring Lyondell. In May 2007, an affiliate of Access Industries filed a Schedule 13D with the Securities and Exchange Commission, disclosing its beneficial ownership of 8.3% of Lyondell stock and Blavatnik's interest in acquiring Lyondell. Lyondell's board recognized that the 13D filing meant Lyondell was "in play," but the board determined to take a "wait and see" approach with respect to a potential transaction with Basell or other suitors.

In late June 2007, Basell announced that it had entered into a merger agreement with another chemical company. After the other target received a competing proposal, Blavatnik refocused on Lyondell. Blavatnik contacted Smith on July 9, 2007, offering to acquire Lyondell for $40 per share. Smith responded that $40 was too low and advised Blavatnik to give Lyondell his "best offer." By the end of the day, Blavatnik made a best offer of $48 per share, which the Court of Chancery found "was undeniably a fair [price] and may well have been the best that could reasonably have been obtained." Blavatnik's proposal also required Lyondell to agree to a $400 million break-up fee and sign a merger agreement by July 16, 2007.

The merger was "negotiated and finalized in less than one week, during which time the directors met for a total of only seven hours to consider the matter." Lyondell's board briefly reviewed Basell's offer on July 10, 2007 and instructed Smith to obtain a written offer from Blavatnik and more details concerning Basell's financing. Blavatnik agreed to the Lyondell board's request on the condition that the board provides a firm indication of interest in his proposal by the end of the day on July 11, 2007. The Lyondell board reconvened on July 11, 2007, determined it was interested in Basell's offer and hired Deutsche Bank Securities as its financial advisor. The Lyondell board later instructed Smith to push back on certain proposed terms of the merger agreement; and on July 15, 2007, Smith contacted Blavatnik to request four concessions: a higher price, a go-shop provision, a break-up fee of 1% during the go-shop period and a reduced break-up fee. Blavatnik was "incredulous" because he had already made his best offer but, as a sign of good faith, agreed to reduce the break-up fee from $400 million to $385 million.

On July 16, 2007, the Lyondell board formally considered the merger agreement, which the board had previously received. Deutsche Bank opined that the merger price was fair, and Lyondell's legal counsel advised that Lyondell would be able to consider other proposals because of the "fiduciary out" provision. In addition, the Supreme Court noted that the Lyondell board had no reason to believe other bidders would emerge, given the price Basell offered and the limited universe of companies that might be interested in acquiring Lyondell. Both the Supreme Court and the Court of Chancery noted that Lyondell's directors were "active, sophisticated and generally aware of the value of [Lyondell] and the conditions of the market in which [Lyondell] operated."

The Lyondell board voted to approve the merger; and at a special meeting of stockholders on November 20, 2007, the merger was approved by more than 99% of the voted shares of Lyondell. No other bidder expressed an interest in acquiring Lyondell during the four months between the merger announcement and the stockholder vote.

Revlon Duties Attach When a Company Embarks on a Transaction That Will Result in a Change of Control

The Supreme Court concluded that the Court of Chancery improperly imposed *Revlon*duties before Lyondell's board decided to sell the company or before a sale had become inevitable. In denying summary judgment with respect to whether Lyondell's board acted in "bad faith," the Court of Chancery focused heavily on the period between the Schedule 13D filing and when Basell's offer was first presented to the Lyondell board, referring to it as "two months of slothful indifference despite *knowing* that [Lyondell] was in play." The Supreme Court disagreed with the Court of Chancery's analysis, finding that *Revlon* duties do not arise simply because a company is "in play" but rather 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." Thus, the Lyondell board's "wait and see" approach was appropriate and within its business judgment because the Lyondell directors' *Revlon*duties did not arise until the directors began negotiating the sale of Lyondell. The Supreme Court determined that the Court of Chancery should have focused only on the time after that date.

There Is No Single Course of Action a Board Must Follow to Satisfy Its*Revlon* Duties

The Supreme Court reaffirmed that there is only one *Revlon* duty – "to [get] the best price for the stockholders at a sale of the company" – and that no court can tell directors how to accomplish that goal because each transaction brings its own unique set of facts and circumstances, many of which are beyond the directors' control. The Court of Chancery, drawing on various precedents, found that a board must "engage actively in the sale process" and must confirm that it has obtained the best available price either by conducting an auction or market check or demonstrating "an impeccable knowledge of the market" in order to meet its burden under Revlon. Because the Lyondell directors did not conduct an auction or market check and did not demonstrate "impeccable" knowledge, the Court of Chancery concluded that the Lyondell board did not discharge the "known set of [*Revlon*] duties." The Supreme Court disagreed, noting that the board members' inaction could not have demonstrated a conscious disregard of their duties, because there are no legally prescribed steps that directors must follow to satisfy *Revlon*.

An Imperfect Effort to Carry Out *Revlon* Duties Does Not Equate to a Conscious Disregard of Duties or "Bad Faith"

The Supreme Court concluded that bad faith will be found if a "fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties." Describing the categories of bad faith set forth in *Disney*, the Supreme Court explained that "bad faith encompasses not only an intent to harm but also intentional dereliction of duty." The Court of Chancery concluded that the Lyondell board's inaction prevented a finding of good faith. The Supreme Court disagreed, noting that directors' decisions must be "reasonable, not perfect," and that if directors fail to act, they breach their duty of care. "Only if [the directors] knowingly and completely fail[] to undertake responsibilities would they breach their duty of loyalty." The Supreme Court further noted that the Court of Chancery "approached the record from the wrong perspective. Instead of questioning whether disinterested, independent directors did everything that they (arguably) should have done to obtain the best sale price, the inquiry should have been whether those directors utterly failed to attempt to obtain the best sale price." The Supreme Court found that the Lyondell directors met several times to consider Basell's offer, were generally aware of the value of Lyondell and attempted to negotiate a higher offer and better terms even though the evidence indicated that Basell offered a "blowout" price; therefore, the directors could not have breached their duty of loyalty by failing to act in good faith.

Impact

The *Lyondell* decision is likely to be influential for several reasons:

- A *Revlon* analysis will apply only to the period after a board begins a negotiation to sell a company, and not when the company is "in play."
- In the future, it is likely to be difficult for plaintiffs to make successful "bad faith" claims against directors, as they may have to prove facts indicating egregious behavior or a complete and utter failure to act.
- Even an imperfect attempt to satisfy *Revlon* duties by a board may be enough to escape a claim of breach.

For Further Information

If you have any questions regarding this Alert or would like more information, please contact any member of the Corporate Practice Group or the attorney in the firm with whom you are regularly in contact.

Notes

1. *Lyondell Chemical Co., et al. v. Walter E. Ryan, Jr., et al.*, No. 401-2008 (Del. Mar. 25, 2009).
2. *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27 (Del. 2006).
3. *Stone v. Ritter*, 911 A.2d 362 (Del. 2006).
4. *In re Caremark Int'l Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996).