IN *RYAN V. LYONDELL CHEMICAL COMPANY*, THE DELAWARE CHANCERY COURT REMINDS DIRECTORS THAT SALE OF CONTROL TRANSACTIONS REQUIRE ROBUST BOARD INVOLVEMENT

On July 29, 2008, the Delaware Chancery Court partially denied the target director-defendants' motion for summary judgment in a case alleging that these directors breached their "*Revlon* duties."[1] The court determined that genuine issues of material fact existed as to (1) whether the independent members of the Board (as defined below) engaged in a satisfactory sale process to acquire the highest available value for stockholders and (2) whether the Board's decision to agree to certain deal protections was reasonable. These possible procedural and deliberative shortcomings led the court to find that the Board's conduct may potentially implicate the good faith component of the duty of loyalty, which would preclude an 8 Del. C. § 102(b)(7) defense on summary judgment and could therefore expose the directors to personal liability (and possible monetary damages) for their conduct.

This case highlights several important issues surrounding the obligations of a board of directors under *Revlon*:

- Claims against independent directors can be fashioned as duty of loyalty claims surviving summary judgment by stating that the directors did not merely err during a sale process but never fully engaged in the process. This claim potentially implicates the good faith aspect of the duty of loyalty, which would preclude an 8 Del. C. § 102(b)(7) exculpatory provision and possibly subject the independent directors to personal monetary liability.

- Directors must involve themselves in sale of control transactions, evidencing a deliberate and thoughtful decision-making approach and a proactive process. It is not sufficient to delegate deal design and negotiation to even the most capable of agents.

- Although short time horizons are not presumptively inadequate, boards should reserve sufficient time to demonstrate that all options and considerations have been examined and thus the company and its stockholders are obtaining the best available price.

- Prior to agreeing to a sale of a company, directors must demonstrate competent knowledge of the company's market or have negotiated mechanisms to ensure that the sale process properly canvasses the market. Such knowledge can be persuasive evidence of a good faith discharge of a board's fiduciary duties.

- The court reaffirmed prior Delaware court decisions holding that the vesting of stock options in connection with a merger is not per se impermissible.

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[1] *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

Facts

Basell AF ("Basell") first expressed interest in acquiring Lyondell Chemical Company (the "Company") in April 2006, offering a price of $26.50 to $28.50 per share. At that time, the board of directors of the Company (the "Board") determined that the price was inadequate and that such a transaction would not be in the best interests of the Company or its stockholders. In the spring of 2007, Basell acquired the right to purchase Occidental Petroleum Corporation's approximately 8% stake in the Company. A Basell affiliate subsequently filed a Schedule 13D with the Securities and Exchange Commission (the "SEC"), disclosing its right to purchase the Company shares held by Occidental Petroleum Corporation, as well as Basell's intent to discuss various transactions with the Company. The Board met to discuss this development, but did not take any responsive action at the time.

In early June, Dan F. Smith, the Company's Chairman and Chief Executive Officer, conducted preliminary negotiations with Basell's Chief Executive Officer, Volker Trautz, where Smith seems to have suggested a willingness to consider a sale of the Company at a price of $48 per share. The Board, unaware of these negotiations and despite the earlier Schedule 13D filing, did not engage in an effort to value the Company or to assess its options in the event that Basell indeed sought to acquire the Company. As a result of a subsequent meeting between Smith and Leonard Blavatnik, the Chairman and President of Basell's parent company, Blavatnik made an offer of $48 per share contingent on the Company's signing a merger agreement within a week and agreeing to a $400 million break-up fee. This offer "represented a 45% premium over the closing share price on May 10, 2007, the last trading day before [public knowledge of Basell's interest in the Company], and a 20% premium over the closing price on the day before the merger was publicly announced."

At a special meeting of the Board on July 10, 2007, the offer was announced and discussed for 50 minutes. At the conclusion of this meeting, the Board asked Smith to seek a written offer from Basell and recessed discussions until July 11. At the subsequent discussion between Smith and Blavatnik, Blavatnik promised a written offer but requested a firm indication of interest from the Board by July 11. At a 45-minute meeting on July 11, 2007, the Board authorized Smith to negotiate with Blavatnik regarding Basell's proposal but did not seek to participate actively and directly in negotiations. Smith went on to request several concessions from Basell, including an increase in the offer price and a go-shop provision, which Blavatnik vehemently rejected, although he did agree to a reduction in the break-up fee to $385 million.

At a subsequent Board meeting, the Board obtained legal and financial advice, including a fairness opinion from Deutsche Bank Securities, Inc. ("Deutsche Bank"), which was hired by the Board only after the final terms of the deal had been cemented. Deutsche Bank opined that the $48 per share price was a fair one, and the Board voted unanimously to approve the merger and to recommend it to the Company's stockholders. The merger was announced on July 17, 2007, seven days after the Board began its review of Basell's offer. At the special meeting held to consider the merger, 99.33% of the Company's stockholders who voted on the matter voted to approve the merger.

Non-*Revlon* Duty of Loyalty Claims

The plaintiff argued, among other things, that the independent members of the Board breached their fiduciary duty of loyalty because they stood to gain financially through the early vesting of their stock options. The court found that the plaintiff had not produced sufficient facts to suggest improper motivation on the part of the independent directors, asserting that "the vesting of stock options in connection with a merger does not create a per se impermissible interest in the transaction." Furthermore, the court noted that directors are considered interested only when they receive a financial interest that is not equally shared by other stockholders. In this case, no such unequal financial interest existed since "accelerated vesting does not confer a special benefit"; on the contrary, stock options are designed to align the interests of the directors with those of the stockholders. Thus, the court granted summary judgment to the defendants on all of the plaintiff's general duty of loyalty claims.

Plaintiff's *Revlon* Claims

The plaintiff claimed that the Board failed to adequately fulfill its duty of care under *Revlon* by (1) engaging in a hasty deliberative process that rendered the Board unable to inform itself as to the Company's value or as to the propriety of the transaction, (2) failing to conduct a market check or to shop the Company and (3) agreeing to unreasonable deal protection devices that served to discourage competing bids. The court initially determined that it could not conclude that the plaintiff would be unable to prove his *Revlon* claim. However, the court noted that if the plaintiff succeeded only in proving his duty of care claim, the only remedy available—monetary damages—would be foreclosed by the Company's exculpatory charter provision adopted in accordance with 8 Del. C. § 102(b)(7). This section of the Delaware Code permits charter provisions that "[eliminate or limit] the personal liability of a director . . . for money damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) for any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law . . . ".[2] Thus, the court found that, "because the Board was independent and not impermissibly motivated," the plaintiff must prove that "the Board failed to act in good faith . . . or otherwise acted disloyally." On this issue, the court found that the Board's failure to engage in "a more proactive sale process" might potentially be interpreted as "a breach of the good faith component of the duty of loyalty."

The Board's Obligations in a Sale of Control

The court explained that although a board's actions in managing a business are ordinarily protected from post hoc judicial review by the business judgment rule, in cases of sales of control, directors must fulfill the duties outlined in *Revlon*. As the court explained, satisfaction of these duties requires a "singular focus on seeking and attaining the highest value available." In evaluating a board's performance, the court must examine "the adequacy [of the board's] decision-making process [and its] actions in light of the circumstances then existing." In many cases, a board's

[2] Citing 8 Del. C. § 102(b)(7).

Revlon duties are fulfilled by active involvement in a contest with multiple bidders. However, in a one-bidder sale process without a canvass of the market, the board must show that it had reliable evidence, through either experience or a robust prior knowledge of the market, that it had obtained the best possible price, or had negotiated for a post-signing market check.

In this case, the court determined that there was evidence in the record to suggest that the Board, which was sophisticated and aware of the value of the Company, had such prior market knowledge. This knowledge stemmed from the Board's routine briefings on the Company's financial outlook, its relatively recent negotiations for the purchase of its refining joint venture, its awareness of the private equity group Apollo Management, L.P.'s negotiations with other companies in the industry and its knowledge of the position of other players and potential buyers in the market.

However, the court criticized the Board for the speed with which the deal was negotiated, vetted and signed. The Board's decision-making process occurred over the course of seven days, with six to seven hours devoted to discussing the deal and half of that time devoted to discussing the final terms of the agreement and obtaining Board approval. The court noted that, perhaps because Smith had engaged in most of his negotiations with Basell without the Board's knowledge, the Board itself did not actually negotiate on the proposal nor did it actively participate in the sale process. The court also criticized the Board for not involving a financial advisor until after the terms had been agreed upon. In sum, the court ultimately determined that despite a likelihood that the Board was sufficiently abreast of the market and was therefore sufficiently certain that it was obtaining a reasonable price and that no other suitors would emerge, as an issue for summary judgment, the process utilized by the Board did not inspire sufficient confidence that the Board had adequately considered all of the alternatives available to the Company.

Ultimately, although the Board may have had sufficient market knowledge and experience to avail itself of the one-bidder strategy, in the execution, the Board was possibly too removed from the process and too hasty in its decision-making to eliminate any genuine issue of material fact as to the fulfillment of its *Revlon* duties. The court's ruling is driven by the fact that on a motion for summary judgment, the nonmoving party, in this case the plaintiff, need not prove his claims to the fullest extent; it is sufficient to merely show that there exists a genuine issue of fact as to such claims. This is a much lower standard than the one confronting a plaintiff seeking an injunction, for example.

The Deal Protection Measures

The court also determined that the Board's "single-bidder strategy" was not sufficiently supplemented by "an effective and relatively unencumbered post-signing market check" since the Board was significantly constrained by the deal protections it sanctioned. Delaware law requires that deal protections not be preclusive or coercive and that they be reasonable in light of the circumstances. The plaintiff challenged the reasonableness of the deal protection measures approved by the Board, arguing that in the aggregate they precluded other bids and left the stockholders with no choice but to accept the proposal. Although the court found that the deal protections in this case were not atypical, it did question whether the Board was reasonable in tying its hands with such restrictive deal protections in light of the fact that the deal had not been adequately vetted in the pre-signing stage. Interestingly, the court appeared to distinguish between a "fiduciary out" provision where other suitors approach the Company of their own accord and a

"go-shop" provision where the Company could proactively discharge its obligations by reaching out to possible suitors. Although the court rejected the argument that the stockholders were left with no choice, it found that for purposes of summary judgment, it could exclude neither the inference that the deal protections were unreasonable nor the inference that they served no purpose other than to suppress the possibility of a competing bid. Thus, the court denied the defendants' motion for summary judgment on this claim.

***Revlon* Shortcomings May Implicate Duty of Loyalty**

According to the court, all of these procedural shortcomings possibly add up to an overall failure to act in good faith, an element of a board's duty of loyalty, since the Board members appear not to have become fully engaged in an active *Revlon* process. The court asserted that "[w]here directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith."[3] Such a finding would render the Board susceptible to personal liability by vitiating the exculpatory charter provision of 8 Del. C. § 102(b)(7).

The court's holding in this case serves to highlight the importance of robust board involvement in all aspects of acquisitions and sales of control, from negotiation to consummation. This is especially clear in light of the court's conclusion that the sale price in this case was fair and perhaps the best that could have been reasonably obtained.

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August 7, 2008

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[3] Citing *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006).