CLIENT
MEMORANDUM

THE DELAWARE SUPREME COURT REVERSES THE DELAWARE COURT OF CHANCERY'S DECISION IN RYAN V. LYONDELL

On March 25, 2009, the Delaware Supreme Court reversed the Delaware Court of Chancery's controversial decision in *Ryan v. Lyondell Chemical Company*. The Delaware Court of Chancery had denied summary judgment with respect to the plaintiff's claim that the directors of Lyondell Chemical Company ("Lyondell") breached their duty of loyalty by failing to act in good faith because they did not engage in a proactive sales process in breach of their *Revlon* duties. The Delaware Supreme Court's decision in *Lyondell* is important for several reasons:

- The Delaware Supreme Court reaffirmed that there is a distinct difference between a director who may have erred or arguably acted inadequately during a sale process and a director who consciously disregards his or her duties. A director's imperfect actions during a sale process may result in a breach of his or her duty of care, while an intentional dereliction of one's duties potentially implicates the good faith aspect of the duty of loyalty. The distinction is meaningful because pursuant to § 102(b)(7) of the DGCL, a corporation may adopt a provision in its charter that limits or eliminates the personal liability of a director for monetary damages for a breach of the duty of care, but not for a breach of the duty of loyalty.

- The Delaware Supreme Court also clarified that "*Revlon* duties do not arise simply because a company is 'in play'" but instead, the "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." Prior to that, directors will continue to be protected by the business judgment rule and the courts will give great deference to the substance of their decisions.

- The Delaware Supreme Court reaffirmed that once a board's *Revlon* duties are implicated, the board only has one duty: "to get the best price for the stockholders at a sale of the company" and that "there is no single blueprint that a board must follow to fulfill its duties."

Facts

During the summer of 2006, Leonard Blavatnik, Chairman and President of Access Industries ("Access"), the parent company of Basell AF ("Basell"), sent a letter to Lyondell's Board of Directors (the "Board"), offering to acquire Lyondell for a price between $26.50 to $28.50 per share, which the Board rejected as inadequate. In May 2007, an affiliate of Access filed a Schedule 13D with the Securities and Exchange Commission, disclosing its right to acquire an 8.3% block of Lyondell shares, as well as Basell's intent to discuss various transactions with Lyondell. The Board immediately convened a special meeting to discuss the Schedule 13D, but did not take any responsive action at the time, and instead adopted a "wait and see" approach. In early June, Dan F. Smith, Lyondell's Chairman and Chief Executive Officer, conducted preliminary negotiations with Basell's Chief Executive Officer. The Board, unaware of these negotiations and despite the earlier Schedule 13D filing, did not engage in an effort to value Lyondell or to assess its options in the event that Basell indeed sought to acquire Lyondell. On July 9, 2007, Smith met with Blavatnik to discuss an all-cash deal at $40 per share, which Smith negotiated up to $48 per share contingent upon Lyondell signing a merger agreement within one week and agreeing to a $400 million break-up fee.

The Board met to review and consider Basell's offer on July 10, 2007. The Board met again on July 11, 2007 and authorized the retention of Deutsche Bank Securities, Inc. ("Deutsche Bank") to act as its financial advisor and directed Smith to negotiate with Blavatnik regarding Basell's proposal. 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 Blavatnik did agree to a reduction in the break-up fee to $385 million. On July 16, 2007, the Board held a meeting to consider the merger agreement, during which the Board obtained legal and financial advice, including a fairness opinion from Deutsche Bank. After considering the advice of its advisors, the Board voted to approve the merger agreement. 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 Lyondell's stockholders who voted on the matter voted to approve the merger.

The Delaware Court of Chancery's Decision

In August 2007, the plaintiff filed suit in the Delaware Court of Chancery alleging that the Board breached its fiduciary duties of care, loyalty and candor. In July 2008, the Court of Chancery granted summary judgment in favor of Lyondell on all claims except whether the Board failed to act in good faith in fulfilling its *Revlon* duties. In its decision, the Court of Chancery 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" and refused to grant summary judgment in favor of the Board.

The Delaware Supreme Court's Decision

The sole issue before the Delaware Supreme Court was whether the Board was entitled to summary judgment on the claim that the Board failed to act in good faith, which would constitute a breach of the Board's duty of loyalty, a breach which is not exculpated under Lyondell's charter. Establishing that the Board failed to act in good faith "requires a showing that the directors knew that they were not discharging their fiduciary obligations." The Delaware Supreme Court concluded that the Court of Chancery reviewed the record under a mistaken view of applicable law. The following three factors contributed to that mistake:

- First, the Court of Chancery erred by focusing on the Board's failure to act during the two-month period between the filing of the Schedule 13D (when Lyondell was effectively put "in play") and July 10, 2007, the date on which the Board began negotiating the sale of Lyondell. The Delaware Supreme Court held that the adoption of a "wait and see" approach was an appropriate exercise of the Board's business judgment and that the Board's *Revlon* duties were not implicated until July 10, 2007, the date on which the Board began negotiating the sale of Lyondell.

- Second, the Court of Chancery incorrectly interpreted *Revlon* and its progeny as imposing a mandatory set of requirements that the Board must satisfy during the sale process. The Delaware Supreme Court held that because of the unique circumstances that each board faces (many of which a board will have no control over), it is inappropriate to impose a mandatory set of actions that a board must take to satisfy its *Revlon* duties. In this regard, the Board was not required to confirm that it obtained the best price available by conducting an auction or a market check, nor was the Board required to demonstrate that it had "an impeccable knowledge of the market" in the absence of conducting an auction or a market check.

- Third, the Court of Chancery incorrectly "equated an arguably imperfect attempt to carry out *Revlon* duties with a knowing disregard for one's duties that constitutes bad faith." The relevant inquiry is not whether the Board did all that it should have done under the circumstances to obtain the best sale price, which failure would result in a breach of the duty of care, but instead whether the Board "utterly failed to attempt to obtain the best sale price," which failure would result in a breach of the duty of loyalty. While the Board did not conduct an auction, the Board did meet several times to consider Basell's offer, was generally aware of the value of Lyondell, solicited and followed the advice of its legal and financial advisors and actively attempted to negotiate both a higher offer (even though Basell offered a "blowout" price) and more favorable deal terms, including a lower break-up fee (which it won) and a go-shop (which it lost). That the Board took these actions "clearly establishes that the Lyondell directors did not breach their duty of loyalty by failing to act in good faith."

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If you have any questions about this decision, please contact the authors of this memorandum, Steven A. Seidman (212-728-8763, sseidman@willkie.com), Robert B. Stebbins (212-728-8736, rstebbins@willkie.com), Laura L. Delanoy (212-728-8662, ldelanoy@willkie.com), or the attorney with whom you regularly work.

Willkie Farr & Gallagher LLP is headquartered at 787 Seventh Avenue, New York, NY 10019-6099, with offices in Washington, D.C., London, Paris, Milan, Rome, Frankfurt and Brussels. Our New York telephone number is (212) 728-8000, and our facsimile number is (212) 728-8111. Our website is located at www.willkie.com.

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