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Delaware Supreme Court in 'Lyondell' Decision Updates Duties of Directors in Response to a Takeover

BY JESSE A. FINKELSTEIN AND DANIEL A. DREISBACH

Directors will likely face the most intense scrutiny of their conduct when the board acts in response to a takeover proposal. In *Lyondell Chemical Company v. Ryan*,[1] the Delaware Supreme Court confirmed important principles regarding both the duties owed by directors, and the standards by which their conduct will be measured.

Ever since its adoption in 1986, courts have struggled to define the outer boundaries of the Delaware director liability exoneration provision Section 102(b)(7).[2] As in many instances, the pressure of the facts in a merger case have brought the issue into better focus.

Acquisition Transaction

This case involved the acquisition of Lyondell Chemical Company ("Lyondell"), the third largest publicly-traded chemical company in the United States. In addition to the chief executive officer, the board was comprised of 10 independent directors.[3]

In 'Lyondell,' the Delaware Supreme Court confirmed important principles regarding both the duties owed by directors, and the standards by which their conduct will be measured.

In 2006, Basell AF ("Basell"), a privately-held Luxembourg company, expressed interest in acquiring Lyondell, followed by a letter to the board proposing a transaction at $26.50 to $28.50 per share. Lyondell determined not to sell, finding the price inadequate.[4]

The following year, Basell filed a Schedule 13D disclosing its right to acquire an 8.3 percent block of Lyondell stock, and Basell's interest in a possible acquisition transaction. The board met soon thereafter, but decided to take a "wait and see" approach. Several days later, Lyondell received an inquiry concerning a possible leveraged buyout ("LBO") of the company, but the proposal was rejected by Lyondell's CEO.[5]

Basell met with Lyondell's CEO to discuss a $40 all-cash offer, which was rejected as too low. Basell then raised its proposal to $44–$45 per share. Lyondell's CEO responded that he thought the board would reject this proposal. Basell increased its bid to $48 per share. Although Basell had no financing contingency, it demanded a $400 million break-up fee.[6]

The board convened for slightly under an hour, and reviewed valuation material that had been prepared by management for presentation to the board at its next regular meeting, which was scheduled for the following day. The board discussed the Basell offer, the potential impact of a pending offer by Basell for Huntsman Industries, a specialty chemical company, and whether a competing offer for Lyondell was likely. The board decided to request from Basell an offer in writing accompanied by additional information on Basell's proposed financing.[7]

Basell set an early deadline for an indication of interest by the Lyondell board. After comparing the benefits of the Basell proposal with the option of remaining independent, the board concluded that it was interested in considering the proposal, retained Deutsche Bank

[1] Del., No. 401, 2008, 3/25/09.
[2] DEL. CODE ANN. tit. 8, § 102(b)(7).
[3] *Lyondell*, slip op. at 3.
[4] *Id.*, slip op. at 4.
[5] *Id.*
[6] *Id.*, slip op. at 5.
[7] *Id.*, slip op. at 5–6.

Jesse A. Finkelstein and Daniel A. Dreisbach are directors of Richards, Layton & Finger, P.A., and represented the outside directors of Lyondell Chemical Company in this case. Mr. Dreisbach argued the appeal before the Delaware Supreme Court.

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Securities Inc. (''Deutsche Bank'') as its independent advisor and instructed its CEO to negotiate.[8]

Plaintiffs argued that the directors had breached their fiduciary duties by, among other things, conducting a failed sales process leading to an insufficient price.

After Huntsman terminated negotiations with Basell, negotiations continued between Basell and Lyondell. Basell completed due diligence, Deutsche Bank rendered a fairness opinion, and Lyondell's board discussed the matter further at a regularly scheduled meeting. The board instructed the CEO to seek a higher price, a ''go-shop'' provision, and a lower break-up fee.[9]

Basell refused to negotiate further, except to reduce its break-up fee to $385 million. The board subsequently reconvened. At that meeting, the financial advisors opined that the Basell deal was an ''absolute home run.'' [10] Moreover, the board was advised that the ''fiduciary out'' provision in the merger agreement was sufficient to permit any superior bidder to emerge. This advice was accompanied by the observation that a higher bid was not likely. The Lyondell board determined to approve and recommend the Basell merger, which was overwhelmingly approved by stockholders.[11]

Plaintiffs argued that the directors had breached their fiduciary duties by, among other things, conducting a failed sales process leading to an insufficient price. Plaintiffs also alleged that the directors had a self-interest in approving the merger, since it would result in cashing out the directors' options.[12]

Summary Judgment Denied

The Court of Chancery denied the motion of the director defendants for summary judgment based on a Section 102(b)(7) charter provision.[13] Despite suggesting that the ''better inference'' favored the defendants, the Chancery Court found that the record did not ''as a matter of undisputed material fact,'' demonstrate the Lyondell directors' good faith discharge of their *Revlon* [14] duties.[15]

Specifically, the Court of Chancery found that defendants had not borne their burden of establishing that they had received sufficient information prior to reaching a conclusion, and expressed concern that the board had not taken action for a period of two months following the filing of the Basell 13D.[16] The Chancery Court held that the actions of the Lyondell directors could constitute bad faith, thus denying them the exculpatory effect of Section 102(b)(7). Accordingly, summary judgment was denied in order to allow the introduction of evidence that related to the good faith conduct of the directors.[17]

Supreme Court Reverses

On an interlocutory appeal *en banc*, the Delaware Supreme Court reversed. Three factors were specifically discussed.

First, the Court of Chancery erred in its application of *Revlon* to the conduct of Lyondell's directors following the 13D filing. *Revlon* applies when a board has decided to pursue a transaction.[18] Not having made a determination to undertake a transaction, the directors at that point had no *Revlon* duties. The directors' ''wait and see'' approach was found to be ''an entirely appropriate exercise of the directors' business judgment.'' [19]

Second, the Chancery Court read *Revlon* as ''creating a set of requirements that must be satisfied during the sale process'' in order for directors to fulfill their fiduciary duties. The Supreme Court confirmed that *Revlon* does not require any one path for directors:

> No court can tell directors exactly how to accomplish that goal [achieving the highest price], because they will be facing a unique combination of circumstances, many of which will be outside their control.[20]

As stated in the *Barkan v. Amsted Industries Inc*. case,[21] the Supreme Court has allowed directors latitude in exercising their discretion while fulfilling their *Revlon* obligations.

'Lyondell' ensures that independent directors of companies with Section 102(b)(7) provisions will not find statutorily exonerated pure duty of care claims transmogrified into duty of loyalty claims.

Third, the Chancery Court incorrectly ''equated an arguably imperfect attempt to carry out *Revlon* duties with a knowing disregard of one's duties that constitutes bad faith.'' [22] To establish a lack of good faith, it must be shown that the directors ''knowingly and completely failed to undertake their responsibilities.'' [23] Liability will not be based on second-guessing decisions of independent directors responding to an acquisition proposal. In its opinion, the Court stated the appropriate standard:

> [B]ad 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.'' The trial court decided that the *Revlon* sale process must follow one of three courses, and that the Lyondell directors did not discharge that ''known set of [*Revlon*] 'duties.' '' But, as noted, there are no legally prescribed steps that directors must follow to satisfy their *Revlon* duties. Thus, the directors' failure to take any specific steps during the sale process could not have demonstrated a conscious disregard of their duties. More importantly, there is a vast difference between an inadequate or flawed effort to carry out fiduciary duties and a conscious disregard for those duties.
>
> Directors decisions must be reasonable, not perfect.[24]

[8] *Id*., slip op. at 6.
[9] *Id*.
[10] *Id*., slip op. at 7.
[11] *Id*.
[12] *Id*., slip op. at 8.
[13] Ryan v. Lyondell Chem. Co., C.A. No. 3176-VCN, 2008 Del. Ch. LEXIS 105 (Del. Ch. July 29, 2008).
[14] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).
[15] *Ryan*, 2008 Del. Ch. Lexis 105, *87.
[16] *Lyondell*, slip op. at 14–15.
[17] *Id*., slip op. at 12.
[18] *Id*., slip op. at 15–16.
[19] *Id*., slip op. at 15.
[20] *Id*., slip op. at 16.
[21] 567 A.2d 1279, 1286 (Del. 1989).
[22] *Lyondell*, slip op. at 12.
[23] *Id*., slip op. at 18.
[24] *Id*., slip op. at 17–18.

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Conclusion

Lyondell, of course, leaves stockholders the option of seeking injunctive and other equitable relief against a transaction. However, independent directors will not be subjected to post transaction liability for duty of care claims dressed in duty of liability pleadings. *Lyondell* is a significant reaffirmation of the Court's approach to evaluating directors' actions in takeover settings. Boards are not required to enter a sales process, nor are there specifically mandated steps for directors to discharge those duties if they determine that a transaction is in the best interests of stockholders.

The case also is important for its application of Section 102(b)(7) provisions. Since the adoption of Section 102(b)(7) over two decades ago, plaintiffs have attempted repeatedly to end-run the protections of the statute. *Lyondell* ensures that independent directors of companies with Section 102(b)(7) provisions will not find statutorily exonerated pure duty of care claims transmogrified into duty of loyalty claims.