

## Revlon Duties Do Not Prohibit Acceptance of A Compelling, Pre-Emptive Bid

By Robert S. Reder, Dean W. Sattler  
and Andrew H. Everett II

In a much-anticipated decision, the Delaware Supreme Court (the “Court”) recently overturned the controversial ruling of the Delaware Court of Chancery (the “Chancery Court”) in *Lyondell Chemical Company v. Ryan, C.A.*, No. 3176 (Del. Sup. Ct. March 25, 2009). The Chancery Court had twice denied the Lyondell directors’ motion for summary judgment in a class action suit brought by Lyondell stockholders who alleged that the directors breached their fiduciary duties by approving the sale of the company to a strategic buyer, despite negotiating a 45% premium to the then-current market price. The Court took issue with the Chancery Court’s rulings at nearly every turn, concluding that “the existing record mandates the entry of judgment in favor of the directors.” The *Lyondell* ruling confirms the authority of disinterested directors to pursue aggressively a transaction that they have determined in good faith to be beneficial to stockholders, even when a full auction process, or even a more limited pre- or post-signing market check, has not occurred due to the demands of a strategic bidder.

### BACKGROUND

Before its sale to Basell AF, Lyondell, a Delaware corporation, was the third largest independent publicly traded chemical company in North America. Dan Smith was

**Robert S. Reder**, a member of this newsletter’s Board of Editors, is a New York-based partner and the co-Practice Group leader of the Global Corporate Group of Milbank, Tweed, Hadley & McCloy LLP. **Dean W. Sattler** and **Andrew H. Everett II** are associates in Milbank’s Global Corporate Group, also located in the New York office.

Lyondell’s Chairman and CEO. Lyondell’s other ten directors were all independent, each with strong business backgrounds. Basell AF is a privately held Luxembourg chemical company controlled by Leonard Blavatnik through his ownership of Access Industries.

Basell first expressed interest in acquiring Lyondell in April 2006. In May 2007, an Access affiliate filed a Schedule 13D with the SEC announcing an 8.3% stake in Lyondell and signaling to the market — and the Lyondell board — that Lyondell was “in play.” At a special meeting, the Lyondell board reacted by deciding to take a “wait-and-see” approach.

On July 9, 2007, Blavatnik approached Smith with an all-cash \$40 per share deal. At Smith’s urging, Blavatnik agreed to raise his offer to \$48 per share, but subject to Lyondell signing a merger agreement containing a \$400 million break-up fee by July 16, just one week away. After meeting on July 10 to consider Basell’s offer, the Lyondell board retained Deutsche Bank as its financial adviser and gave Smith the green light to continue negotiations with Blavatnik.

Smith met with Blavatnik on July 12, seeking a higher price, a “go-shop” provision (allowing the Lyondell directors to market the company during the pre-closing period) and a reduced break-up fee. Blavatnik would agree only to reduce the break-up fee from \$400 million to \$385 million as a “sign of good faith.” At a July 16 special meeting, Deutsche Bank opined to the board that the proposed merger price was fair, describing the 45% premium bid as “an absolute home run.” The Lyondell board voted to go forward with the merger, which was ultimately approved by more than 99% of the shares voted at a Lyondell special stockholders’ meeting held on Nov. 20, 2007 (in a shocking sign of the times, the combined Basell/Lyondell enterprise filed a voluntary petition for bankruptcy law protection on Jan. 6, 2009, less than a year and a half later).

Subsequently, a class action complaint was filed, alleging that the Lyondell directors had breached their “fiduciary duties of care, loyalty and candor ... and ... put their personal interests ahead of the interests of the Lyondell shareholders.” The Chancery Court refused to grant summary judgment to the directors on two discrete claims of the stockholders, one attacking the process by which the directors sold the company, and the other challenging deal protection provisions contained in the merger agreement. The directors appealed this ruling and, on March 25, 2009, reversed the Chancery Court decision and remanded the case to the Chancery Court with orders to grant the Lyondell directors’ motion for summary judgment on the two claims.

### THE COURT’S ANALYSIS

At the outset, the Court observed that “[t]he remaining claims are but two aspects of a single claim under *Revlon* ... that the directors failed to obtain the best available price in selling the company.” Setting the legal framework for its analysis of these claims, the Court noted that *Revlon* does not create new fiduciary duties, but requires only that “the board must perform its fiduciary duties in the service of a specific objective: maximizing the sale price of the enterprise.” The Court then observed that, due to an exculpatory provision included pursuant to § 102(b)(7) of the Delaware General Corporation Law (the “DGCL”) in Lyondell’s charter (which protects directors from personal liability for breaches of the duty of care), liability in this case “turns on whether any arguable shortcomings on the part of the Lyondell directors also implicate their duty of loyalty, a breach of which is not exculpated” under DGCL § 102(b)(7). Because the Chancery Court had determined that the Lyondell board was “independent” and unmotivated by “self-interest or ill will,” the Court further narrowed its inquiry to “the sole issue [of] whether the directors ...

breached their duty of loyalty by failing to act in good faith.” Citing *In re Walt Disney Co. Deriv. Litig.*, 906 A. 2d 27 (Del. 2006), the Court explained that failing to act in good faith, or acting in “bad faith,” includes “not only intent to harm but also intentional dereliction of duty.” Such dereliction, and therefore a breach of the duty of loyalty, “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.’”

With this legal framework in mind, the Court highlighted three discrete factors that contributed to what it viewed as the Chancery Court’s misapplication of the legal principles developed under *Revlon*, *Caremark*, *Disney* and their progeny.

First, the Court concluded that the Chancery Court prematurely applied the duties imposed by *Revlon*, inappropriately keying on “the directors’ failure to act during the two months after the filing of the Basell Schedule 13D” as “‘two months of slothful indifference’” during which “they ‘languidly awaited overtures from potential suitors.’” The Court found this analysis to be misplaced, as “*Revlon* duties do not arise simply because a company is ‘in play.’ 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.” Even though the directors were technically “on notice that Basell was interested in acquiring Lyondell,” the Court concluded that their decision to “‘wait and see’ ... was an entirely appropriate exercise of the directors’ business judgment.” Accordingly, the Court instructed that *Revlon*, and its mandate on directors to seek the best available price, did not apply until that crucial week during which “the directors began negotiating the sale of Lyondell” with Basell.

Second, the Court observed that the Chancery Court, in reviewing the board’s conduct during this crucial week, arrived at “the erroneous conclusion that directors must follow one of several courses of action to satisfy their *Revlon* duties.” Rejecting this notion, the Court explained that “[t]here is only one *Revlon* duty — to [get] the best price for the stockholders at a sale of the company.’ No court can tell directors how to accomplish that goal,” the Court explained, because “there is no single blueprint that a board must follow.”

Third, the Court stated that because there are “no legally prescribed steps that directors must follow to satisfy their *Revlon* duties, [i]nstead of questioning whether disinterested, independent directors did everything that they (arguably) should have done to obtain the best sale price, the [Chancery Court’s] inquiry should have been whether those directors utterly failed to attempt to obtain the best sale price.” Drawing the critical distinction between the duties of care and loyalty, the Court explained that “if the directors failed to do all that they should have under the circumstances, they breached their duty of care. Only if they knowingly and completely failed to undertake their responsibilities would they breach their duty of loyalty.” For that, an “extreme set of facts [is] required.”

Finally, in examining the record that the Chancery Court found so lacking, the Court saw little basis to support a finding of bad faith on the part of the directors. In reaching this determination, the Court pointed to “several undisputed facts that would support the entry of judgment in favor of the Lyondell directors.” These included the facts that the Lyondell directors met “several times” during the week that the board was in *Revlon* mode, and that “the directors were active, sophisticated, and generally aware of the value of the Company and the conditions of the markets” and “had reason to believe that no other bidders would emerge.” Furthermore, Lyondell’s CEO had “negotiated the price up from \$40 to \$48 per share — a price that Deutsche Bank opined was fair” and described to the board as “an absolute home run.” Finally, “no other acquiror expressed interest during the four months between the merger announcement and the stockholder vote.”

Ordinarily, the Court concluded, it “would not question the Chancery Court’s decision to seek additional evidence if the issue were whether the directors had exercised due care.” However, “[w]here, as here, the issue is whether the directors failed to act in good faith, the analysis is very different.” Even assuming that the “Lyondell directors did absolutely nothing to prepare for Basell’s offer, and that they did not even consider conducting a market check before agreeing to the merger,” the “record clearly establishes that the Lyondell directors did not breach their duty of loyalty by failing to act in good faith.” Accordingly, the Court reversed the Chancery Court’s ruling and ordered that summary judgment be awarded to the directors.

## CONCLUSION

When the Chancery Court refused to grant summary judgment to the Lyondell directors, those who follow developments in Delaware corporate law were concerned, and justifiably so, that directors could be subjected to personal liability for accepting an attractive, but time-pressured, pre-emptive bid from a strategic buyer, at least where the directors were not able to negotiate a “go-shop” provision. Seemingly, the Chancery Court extended its growing suspicion of private equity buyouts negotiated by conflicted managements and approved by less-than-vigilant boards to arm’s-length transactions negotiated between strategic players. See, e.g., *In re Netsmart Technologies, Inc. S’holder Litig.*, C.A. No 2563-VCS (Del. Ch. 2007). The Court’s ruling in *Lyondell* dispels that concern.

The *Lyondell* ruling and analysis provides welcomed clarity with respect to a board’s duties under *Revlon*, unequivocally holding that “*Revlon* duties do not arise simply because a company is ‘in play.’ 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.” Furthermore, *Lyondell* serves as a reminder that directors do have a measure of flexibility in satisfying their duties when *Revlon* is applicable, because their “decisions must be reasonable, not perfect.” As a result, the Court’s holding addresses — and provides comfort with respect to — a common challenge faced by directors in change of control situations: the need to act expeditiously and decisively in the often fast-paced and unforgiving M&A deal environment, while still dispatching their duties of care and loyalty. If nothing else, *Lyondell* stands for Delaware judiciary’s recognition of the need for, and endorsement of, such agility.