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NEWSLETTER OF THE MERGERS & ACQUISITIONS PRACTICE GROUP OF MANATT, PHELPS & PHILLIPS, LLP

Delaware Supreme Court's Reversal Clarifies Application of *Revlon* Duties to Boards of Directors

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The following updates our Newsletter dated September 2, 2008, regarding the *Lyondell Chemical Company v. Ryan* case to reflect the recent decision of the Delaware Supreme Court to reverse the lower court with respect to the scope of boards of directors' Revlon duties.

The *Lyondell v. Ryan* case involved the $13 billion acquisition of Lyondell Chemical Company by Basell, AF, a privately held Luxembourg company. On July 29, 2008, the Delaware Court of Chancery denied summary judgment to the directors of Lyondell with respect to stockholder claims alleging that the Lyondell directors did not obtain the best price possible for the company. The lone issue on appeal was whether the board of directors breached their duty of loyalty by failing to act in good faith in their actions taken during the sale of Lyondell.[1]

On March 25, 2009, the Delaware Supreme Court reversed the Court of Chancery's ruling on the duty of loyalty issue, concluding that the directors of Lyondell did not breach their fiduciary duty by failing to act in good faith in fulfilling their *Revlon* duties in connection with Lyondell's merger with Basell. Broadly speaking, these duties under *Revlon* require a target company's board of directors to act in a manner to maximize the sale price of the enterprise. With respect to the *Lyondell* case, the Supreme Court determined that the Court of Chancery had reviewed the existing record "under a mistaken view of the applicable law" in the following respects: (1) by misapplying the timing of when the *Revlon* duties are imposed;

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and (2) by concluding that there is a clearly defined process for directors to follow to fulfill their duties under *Revlon*. Therefore, had the lower court correctly interpreted the law, it would not be possible at trial for the plaintiff to demonstrate that the board of directors had failed to act in good faith to satisfy their *Revlon* duties.

Applicable Timing of *Revlon* Duties

The Supreme Court held that the Court of Chancery erroneously examined Lyondell's directors' duties under *Revlon*. The Court of Chancery had focused heavily on the actions of the directors during the two-month period between the time when Basell made a Schedule 13D public disclosure that purportedly put Lyondell's board and stockholders on notice that the company was "in play" and the time when Basell's offer was first presented to Lyondell. Instead, the Supreme Court found that the conscious decision of Lyondell's board to take a "wait and see" approach was "an entirely appropriate exercise of the director's business judgment," and re-affirmed that the board's *Revlon* duties need to be exercised only after the board has either decided to sell the company, or at a point when the sale of the company becomes inevitable.

The Supreme Court determined that, during the two-month period between Basell's public disclosure and the beginning of negotiations between Lyondell's chairman and Basell's chairman, the Lyondell board did not have a duty to actively canvass the market or take other steps to secure the best price possible for the company. In this context, the decision to go about business as usual while Basell attempted, and ultimately failed, to negotiate a deal with another potential buyer, could have contributed to Basell calculating an even higher value for Lyondell.

Process for Exercise of *Revlon* Duties

The Court of Chancery also denied Lyondell's directors' motion for summary judgment because it believed that it was possible for the plaintiff to establish that the directors acted wrongly in their process of negotiating and selling the Company during the week when negotiations with Basell took place. The Court of Chancery believed that, to properly meet the *Revlon* standards, the board was required to act pursuant to a specific course of action based upon prior decisions where courts applied *Revlon*.

The Supreme Court disagreed with the lower court's approach, determining that when negotiating the sale of a company, each board of directors faces "a unique combination of circumstances, many of which will be outside their control." Thus, the court determined that no singular course of action taken by other companies may necessarily be what is required for directors to make a good faith attempt to secure the best price possible for their company. When negotiating a sale, each target company must work within unique timeframes and under different market conditions. In taking this approach, the Supreme Court signaled that stockholder plaintiffs must demonstrate wrongful conduct by a target's board other than merely showing how the directors of a target did not follow the same actions outlined in the *Revlon* line of cases. Rather, provided a board took measures they felt were appropriate for their company to get the best price, they are able to comply with *Revlon*.[2]

Standard for Acts of Bad Faith That Would Constitute a Breach of Duties of Loyalty

During their review of whether the board could be found to have acted in bad faith considering the standards set forth regarding timing of and process for invoking *Revlon*, the court cited its decision *In re Caremark International Derivative Litigation*. In *Caremark*, the court held that "only sustained and systematic failure of the board to exercise oversight can establish the lack of good faith that is a necessary condition to liability" (under the duty of loyalty). Such a breach can only stem from a situation where the directors "knew they were not discharging their fiduciary obligations."

While the Supreme Court agreed that there was potential that Lyondell's board did not use due care in obtaining the best possible price for the company, it found that additional fact finding was unnecessary to make clear whether the board had acted in good faith. Because there is no specific set of procedures for carrying out the *Revlon* duties, it would be impossible for the court to determine that the actions taken by the Lyondell directors in attempting to satisfy *Revlon* could have been in bad faith, unless the conduct meets the failure of oversight standard expressed in *Caremark*. The Supreme Court added, "there is a vast difference between an inadequate or flawed effort to carry out fiduciary duties and a conscious disregard for those duties." The court stated that the latter standard is required in order to constitute actions of bad faith.

Conclusions – "Take Aways"

The Delaware Supreme Court's decision is important for a number of reasons. The court has effectively "raised the bar" for stockholder plaintiffs to successfully challenge the actions of a target company's board of directors under *Revlon* (or has confirmed that the bar is raised with respect to such challenges) – at least where liability under the duty of care is precluded by an exculpatory clause in the corporate charter and the plaintiff must therefore proceed, if at all, under a duty of loyalty/bad faith theory. Specifically, the court determined that (1) *Revlon* duties only apply to the period after a board actually begins negotiations to sell a company; (2) boards face unique circumstances in any particular sale transaction and therefore no singular course of action applies to boards to show compliance with their *Revlon* duties; and (3) to establish a "bad faith" claim against independent directors, a plaintiff needs to be able to demonstrate that there are facts to indicate a complete and utter failure to act by the board of directors in complying with their duties. Therefore, where no bad faith can be demonstrated with respect to an independent board of directors, an attempt by the board to satisfy their *Revlon* duties may be enough to escape a claim of breach, so long as the organizational documents of the company contain the statutory exculpatory provisions for breach of duty of care.

While this decision arguably narrows the *Revlon* obligations imposed on a target company's board of directors, boards should nonetheless be cognizant of their duties, and seek advice and follow best practices to ensure their obligations are fulfilled.[3]

[1] Lyondell's charter includes an exculpatory provision protecting directors from personal liability for breaches of the duty of care; thus, the directors can only be held liable for a breach of the duty of loyalty. Because the trial court determined that the directors were independent and not motivated by self-interest or ill will, the stockholders could only demonstrate a breach of the duty of loyalty of the directors by showing that the directors failed to act in good faith.

2 The Lyondell directors negotiated the purchase price to a substantial premium, hired an investment bank to render a fairness opinion, reviewed valuation models from legal and financial advisors, and had their banker consider other possible acquirers. The Lyondell board and its banker believed that no other potential acquirer would top Basell's offer and that the company could rely on exercising a "fiduciary out" decision, notwithstanding the no-shop provision in the merger agreement.

[3] *See* our Newsletter dated September 2, 2008, for examples of best

practices for boards to follow in complying with their *Revlon* duties. A copy of this Newsletter is available here.

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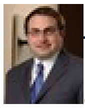

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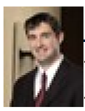

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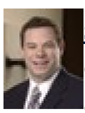

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