Delaware Supreme Court Reconfirms That Bad Faith Requires Intentional Dereliction

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Introduction

On March 25, the Delaware Supreme Court eliminated directors' concerns created by a troublesome Court of Chancery opinion from last year. In *Lyondell Chemical Company v. Ryan*, the Delaware Supreme Court further clarified the deference provided to directors in the sales process under their *Revlon* duties and clarified what constitutes a breach of the duty of loyalty due to a failure to act in good faith.[1] The lower court decision had raised a specter of increased risk of personal liability for directors by expanding concepts of breaches of the duty of loyalty, which, unlike breaches of the duty of care, are not protected by exculpatory charter provisions under 8 *Del. C.* § 102(b)(7). First, the Court held that there is but one *Revlon* duty: to get the best price for the stockholders at the sale of the company. In reversing the Court of Chancery opinion, the Delaware Supreme Court held that there are no legally prescribed steps that directors must take to fulfill those duties, nor is there a single blueprint that a board must follow. Second, the Court held that directors breach their duty of loyalty by failing to act in good faith only if they knowingly and completely fail to undertake their responsibilities. The Court further stated that an extreme set of facts is required to sustain a claim that disinterested directors were intentionally disregarding their duties. The Delaware Supreme Court not only reversed the Court of Chancery, but also entered summary judgment in favor of the directors. In a clear and straightforward opinion, the Delaware Supreme Court sends a strong message that, absent extreme conscious abdication of duties, independent disinterested directors should not be overly concerned about personal liability.

Facts

In May 2007, an affiliate of the acquirer had obtained the right to acquire an 8.3% block of Lyondell Chemical Company (“Lyondell”), the target, and filed a Schedule 13D that also disclosed the acquirer's interest in other possible transactions with Lyondell. The Lyondell board recognized that Lyondell was now “in play,” and after convening a special meeting, decided to take a “wait and see”

approach. During the initial discussions on July 9, 2007, between the CEO of Lyondell and the owner of the acquirer, Blavatnik, Blavatnik discussed an all-cash deal for $40 per share, and even raised his offer to $44-$45 after the CEO of Lyondell rebuffed him initially. At the end of the day, the CEO of Lyondell was able to persuade Blavatnik to offer a “blowout” price of $48 per share, a 45% premium over the closing stock price before the market learned of the Schedule 13D. Blavatnik would, however, require Lyondell to agree to a $400 million break-up fee and sign the merger agreement in one week. During this week the directors met several times, evaluated Lyondell's value and the likelihood of obtaining a better price, and retained Deutsche Bank Securities, Inc. (“Deutsche Bank”) as its financial advisor. The CEO of Lyondell also attempted to negotiate better terms, but with little success. Deutsche Bank opined that the price was fair and the bank's managing director described the price as an absolute home run. After the weeklong negotiation, the merger agreement included a no-shop provision (but it did contain a fiduciary out provision), matching rights for the acquirer, a slightly reduced $385 million break-up fee, and the unaltered $48 per share price. The Lyondell board then voted to approve the merger. Months later at a special stockholders meeting, the merger was also approved by more than 99% of the voted shares.[2]

Discussion

In finding that the directors may have violated their *Revlon* duties, the Chancery Court had focused on the actions of the directors between the time the Schedule 13D was filed and the offer by Blavatnik. Although Lyondell may have been in play during this time, the Delaware Supreme Court held that “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.” Therefore, the Court found that the wait and see approach of the directors was an appropriate exercise of their business judgment.

In addition, the Chancery Court had also synthesized case law and held that for directors to discharge their duties under *Revlon*, the directors must confirm they are obtaining the best price either by conducting an auction, by conducting a market check, or by demonstrating an impeccable knowledge of the market. Because the Lyondell directors did not do any of these, the Chancery Court found that it was a triable question of fact and not subject to disposition on summary judgment whether the directors had acted in bad faith, because the directors had failed to act in the face of a known duty to act, demonstrating a conscious disregard for their duties. The Delaware Supreme Court stated that because there are no prescribed steps a director must take to discharge his *Revlon* duties, the failure of a director to take any specific step could not demonstrate that the director acted with a conscious disregard for his duties.

The Court then clarified what a breach of the duty of loyalty by failure to act would require from a director so that the dereliction of duty might give rise to personal liability notwithstanding a § 102(b)(7) exculpatory provision. The Court distinguished clearly between a breach of the duty of care, for which there is protection under § 102(b)(7), and the duty of loyalty, for which there is no protection. The Court stated: “[I]f 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.” In addition, the Court stated that the question to be asked is not whether the directors did everything they should have done, but whether they “utterly failed to attempt to obtain the best sale price.”

Conclusion

Although the current headlines reflect angry demands for retribution against management and directors for outsized business failures, the Delaware Supreme Court has calmly stood by its principles that independent directors' decisions must be given deference and directors must be given appropriate insulation from personal liability. This decision reaffirms the latitude directors are given in the sales context, and the protection from personal liability directors are afforded as long as they not knowingly and intentionally disregard their obligations.

[1]*Lyondell Chem. Co. v. Ryan*, No. 401, 2008, C.A. No. 3176 (Del. March 25, 2009).

[2]Not to be lost is the irony, we note, that while the plaintiffs have sued the directors for not obtaining a higher price, Lyondell Basell has now filed for bankruptcy and the creditors seek to challenge the merger payments to the stockholders for being too rich.

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